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On

Market Data

Committee on Financial Services

Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

United States House of Representatives

March 14, 2001

Chairman Baker, Vice Chairman Ney, Ranking Member Kanjorski and Members of the Subcommittee, I am Robert G. Britz, Group Executive Vice President of the New York Stock Exchange, Inc. ("NYSE" or "Exchange"). The Exchange's equities group, which I lead, is responsible for the day-to-day operation of our market and our data processing sites, for our technical infrastructure and software development, and for our information business, which includes market data.

On behalf of the NYSE and our Chairman, Richard A. Grasso, I thank the Subcommittee for providing this forum for discussing the subject of market data and for the opportunity to appear before you this morning. We believe that advancements in technology create an opportunity for deregulation and enhanced competition in this arena, making the Subcommittee's hearings particularly timely.

THE "WHAT", "HOW" AND "WHY" OF MARKET DATA

Allow me to "set the table" for my remarks by briefly defining what "market data" is, how it is disseminated and regulated, and why it is so vital to capital formation.

"Market data" includes last sale prices, which are the most recent reports of prices at which stocks have traded. Market data also includes bid and asked quotations, which are the highest announced bid price that buyers in our market are willing to pay, and the lowest announced offer price that sellers in our market are willing to accept.

In 1975, Congress extensively amended the Securities Exchange Act of 1934 to strengthen the oversight of the Securities and Exchange Commission over the Exchange and other self-regulatory organizations. Among many other changes, it directed the SEC to facilitate the creation of a "national market system", or "NMS", among the NYSE, the other exchanges and the National Association of Securities Dealers. In assigning the SEC that responsibility, Congress gave the SEC broad powers to regulate the dissemination of market data, including authority to require the SROs to disseminate market data jointly.

Since that time, the Exchange has participated with the other SROs in a market data consortium called the "Consolidated Tape Association", or "CTA". Pursuant to a joint venture agreement called the "CTA Plan", which has been filed with and approved by the SEC under its NMS authority, the SROs jointly:

- Operate the facilities to consolidated and disseminate market data,

- Govern the terms and conditions of the receipt, re-dissemination and use of market data through SEC-filed contracts with vendors, broker-dealers and other users of market data,

- Charge for market data pursuant to fees filed with the SEC, and

- Share the net revenues.

As the largest market for the trading of the stocks it lists - the NYSE executes more than four times the number of shares as all other markets combined - the NYSE administers CTA's contracts and fee structure.

Criticism of the consortium and of the SEC's stewardship led the SEC in December 1999 to issue a concept release on market data that included proposals to add additional layers of bureaucracy to the consortium and to embrace a utility ratemaking model. The responses to the release underscored the divergence of views among SROs, vendors and broker-dealers, prompting the SEC to bring together two dozen representatives of those groups and others in an Advisory Committee on Market Information. Joel Seligman, Dean of the Washington University School of Law at St. Louis, chairs the committee. I serve as the Exchange's representative.

MARKET DATA AND CAPITAL FORMATION

Allow me to turn now to the question of why market data is so vital to capital formation.

If I mention the New York Stock Exchange to you, I may evoke an image of our columned façade on Broad Street, or of men and women rushing across our trading floor in order to get their customers the best price, or of the 3000 great U.S. and non-U.S.

companies that privilege us by listing their stock. Or you might think of our computers and fiber optics that enable us to trade 6.0 billion shares a day – in decimals – without a hitch. Or I might call to mind my 550 colleagues who regulate Merrill Lynch, Goldman Sachs and our other great member organizations.

Each of these images would be accurate.

But you would not have identified our core product:

Market data.

When two investors trade, the execution is important to just them. But the ***price*** of the trade is important to millions of others around the world - for deciding their next market action, for pricing their portfolios, for valuing their stock options and for providing a report card on how well management is discharging its responsibilities to them as shareholders.

Said another way, the NYSE exists to manufacture stock prices and distribute them pervasively. We tell the world what a fine slice of ownership - a single share - of the global enterprise that is Exxon, for example, is worth on a moment-by-moment basis. Through our auction, we take raw material - orders from investors entrusted to brokers, some with vast distribution capabilities, others with simply a telephone and a workstation on our trading floor - and turn it into a snapshot of a corporation's value. Our "factory" is not merely the trading floor itself, but a vast, fast, secure and reliable delivery and reporting system. Moreover, the entire process occurs in a "fishbowl" - literally on national television, but also through the immediate and broad dissemination of the data and under the watchful eye of those 550 of my partners that work in our Regulatory Group.

WHY CONTROVERSY?

Before I turn to the five specific issues concerning market data that Chairman Baker included in his March 9 letter to our Chairman, I owe you my best explanation as to why there has been so much discussion about market data over the past several years. But, to tell you the truth, I am surprised myself.

Notwithstanding its vital importance to the efficient functioning of our capital markets, market data is by no means a glamorous part of our business. It's like the water supply – everyone takes it for granted until the day that the faucet drips rust. Indeed, given the regulatory scheme I have mentioned, it can get downright arcane.

So, while I may not be much help in telling you "what all the noise is about", I can tell you what it is ***not*** about:

- It is clearly not about ***access*** by investors to market data - they cannot avoid it.

- It cannot be about the ***cost*** of data to investors – it's free.

- And it cannot be about the cost of data to ***brokers*** - the cost has declined dramatically over the past 25 years and, in any event, brokers levy the fees on themselves.

Allow me to back up my observations with some explanation.

CONSUMERS HAVE FREE ACCESS

Individual investors, and the general public for that matter, have access to unlimited real time data through a wide variety of delivery systems - PC's, telephone, television, PDA's, pagers, automated teller machines, etc. Market data is available in the home and in public places - libraries, schools, airports, restaurants, train stations, shopping malls and literally on the street. In contrast to commentators who imply that investors are struggling for access to real-time data, in truth, it is hard to avoid it. Simply stated, the data is pervasive and, from many sources, absolutely FREE.

COSTS HAVE FALLEN DRAMATICALLY

As I have noted, consumers do not pay market data fees. As that fact has become more generally understood, much of the “debate” about the pricing of market data has shifted to the question of how much of the costs of funding the Exchange should be allocated among broker-dealers through fees denominated as “market data” fees.

This, too, turns out to be a very curious debate. Since the Exchange began collecting market data fees 130 years ago, our broker-dealer members have been levying the fees on themselves.

Moreover, for at least 75 years (our budget archives do not go back any further), the contribution of market data fees to our overall revenue has never exceeded 25 percent. It has not breached 18 percent since Congress first legislated in this area in 1975. In addition, over the past 15 years, the cost of our market data has declined dramatically – more than 80 percent. Prices for our market data have either declined or remained unchanged.

USERS LEVY FEES ON THEMSELVES

Why this is so presents no mystery. The NYSE does not so much establish prices as allocate costs. Representatives of our constituents - member broker-dealers, listed companies, institutional investors and the public at large - establish NYSE prices by first determining the NYSE’s funding needs, and then allocating the resulting costs among themselves.

Twenty-four men and women long experienced in business and the public sector -- 21 who are CEOs of users of Exchange services and three who are Public Directors with no financial interest in the outcome -- determine the Exchange’s funding. They then allocate most of the non-regulatory costs of running the Exchange between listed companies and member broker-dealers (with institutional investors and other non-members contributing the balance) by establishing fees denominated as “listing fees”, “transaction fees” and “market data fees”. If they change the allocation, it must withstand scrutiny by Board representatives of potential “winners” and “losers”, as well as by the Directors representing solely the public interest.

Board action is the last stop in our constituent process. Before the Board reallocates any costs, Exchange staff vets the proposed change with user groups. In the case of market data fees, the process includes our ongoing interaction with broker-dealers (and market data vendors) in the course of our providing services to them, as well as our ongoing participation in industry associations. The NYSE staff seeks consensus by discussing new fee ideas with constituents who advocate their varying business models.

That this mechanism produces a fair result does not surprise economists. Through their representatives, the users of a complex, interdependent set of services determine what they pay. In fact, Congress itself recognized that this kind of competition among users produces the best and fairest allocation of costs: in 1975, it wrote into the 1934 Act requirements that exchanges afford fair representation of brokers, issuers and investors and fairly allocate costs among them.

Were the “belt” of constituent cost allocation ever to break, the SEC review process provides “suspenders”. However, in the 26 years since Congress authorized the SEC to regulate market data fees, the SEC has never rejected a CTA fee proposal as being unfair or unreasonably discriminatory. Indeed, only recently have the SEC “suspenders” come into play -- not because of a ***failure*** of fair allocation, but because of a single user's campaign to ***avoid*** it.

Maybe it’s because we both got our start in 1792, but the idea of our constituents allocating the costs of running the Exchange among themselves is no different in principal than the budgetary and tax process here in Congress. Acting through their Board representatives, the Exchange’s constituents arrive at a fair allocation of costs through give-and-take. These Board representatives recognize that their constituents all benefit from funding the Exchange -- and that each user must contribute its fair share.

The long-term stability in the proportion of our costs covered by market data fees has transcended the ebb and flow of the particular business models of our constituents. Nevertheless, because those who approve the Exchange’s budget and its market data (and other) fees are the ones who pay, the role of market data fees in our funding is far from immutable. Our constituents can raise or lower any fee -- thereby reallocating among themselves the costs of operating the Exchange -- any time they want.

WITHDRAWAL FROM THE MARKET DATA CONSORTIUM

You may be aware that the Exchange has advised the SEC that it wishes to withdraw from the CTA consortium. In view of our solid track record of making a high-quality data service ubiquitously, inexpensively and reliably available to securities professionals and consumers, as well as the fair way in which we allocate our costs, this determination by our Board of Director’s last April might surprise you.

Let me say that it is not at our initiative that we propose to end our joint effort with the other SROs, any more than it was at our initiative that we began it in the first place. The impetus came from the SEC's December 1999 concept release on market data, which, as I noted, proposed to add new layers of bureaucracy and to embrace a utility ratemaking model. It also came from the growing dysfunction of the SRO consortium in the face of the nation's evolving securities market structure.

We have been confirmed in our course by the subsequent crystallization of the legal perils of joint activity even when taken within the framework of an SEC-approved plan.[1] We are also troubled by the contradiction between continued joint dissemination and the prescription last year by the Antitrust Division and the SEC that each exchange must acquire and manage its own data transmission capacity independently.[2]

Our decision stems from our belief that technology and market forces provide a workable way for the NYSE and the rest of the industry to assure the display of consolidated data after the NYSE's exit. So we believe the consortium is no longer necessary.

But, to be clear, the NYSE is not calling for the abolition of the SRO consortium. Nor do we believe our withdrawal will trigger any crisis in data consolidation and dissemination. Similarly, we are not trying to promote a new market data distribution model for the industry. That would be both presumptuous and well beyond our ambition to exit the consortium.

THE WORK OF THE SELIGMAN COMMITTEE

As my remarks suggest, the Subcommittee is joining a conversation among the SEC, the SROs and the users of market data that began in earnest when the SEC issued its 1999 concept release. That conversation continues in the work of the Seligman Committee. The Exchange recognizes that the issues are complex and arcane, and believes that the SEC's effort to clarify the issues and search for consensus through its advisory committee deserves to be given a chance. Accordingly, the Exchange has deferred formally seeking approval of the SEC for its withdrawal from the SRO consortium, and is participating actively in the Seligman Committee's work.

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[1] Recently-settled proceedings of the Antitrust Division of the Department of Justice and the SEC alleged that a decision taken by the Amex, CBOE, PCX and PHLX to limit the capacity of OPRA effectively constrained multiple trading in certain options classes. *United States v. American Stock Exchange et al.*, No. 1:00CV02174 (D.D.C. filed Sept. 11, 2000), Complaint at 10; *In the Matter of Certain Activities of Options Exchanges*, AP File No. 3-10282, Exchange Act Release No. 43268 (Sept. 11, 2000), Order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions at 4, 6.

[2] The settlement in the options antitrust matter imposed the prescription on the Amex, CBOE, PCX and PHLX. See *United States v. American Stock Exchange et al.*, Competitive Impact Statement of United States at 21. At the May 10, 2000 CTA meeting, the SEC staff requested that the constituent exchanges file amendments to the CTA Plan that would meet this independent capacity standard as well.

Both in response to the concept release and in the context of the Seligman Committee's deliberations, the Exchange has worked hard to articulate its views over the last year. So that you may have the benefit of our efforts, we submit for the record three key position papers:

- **Exhibit A**, which is our 2-1/2 page explanation of how the users of market data establish market data rates through their representatives on the NYSE Board of Directors: my February 8, 2001, letter to the Members of the SEC Advisory Committee on Market Information, "Market Power in Pricing Market Data",

- **Exhibit B**, which is our 13-page description of how market data would continue to be disseminated after our withdrawal from the consortium: my December 1, 2000, letter to Dean Seligman, "Competing Consolidators Model", and

- **Exhibit C**, which is the 23-page cover letter summarizing and transmitting our 240-page response to the SEC's concept release: "Comments to Securities and Exchange Commission Concept Release on 'Regulation of Market Information Fees and Revenues'" (April 10, 2000). Exhibit C also includes the table of contents for the full response, which is available in its entirety at http://www.sec.gov/rules/s72899.htm.

We hope these submissions contribute to your work.

SPECIFIC ISSUES

In regard to the five specific issues that Chairman Baker included in his March 9 letter to our Chairman, allow me to briefly summarize our views and direct the Subcommittee and its staff to our more detailed discussions in our three submissions:

Benefits and Drawbacks of the Current Regulatory Structure - The current regulatory scheme depends in large part on otherwise vibrantly competing exchanges coming together in consortium to disseminate market data, to set prices for that data and to share the resulting revenues. As noted, our decision to withdraw from the consortium recognizes that today's technology and market forces provide a workable way for the NYSE and the rest of the industry to assure the display of consolidated data after the NYSE's exit. It further recognizes that here, as in other areas of the economy, the best answer lies in unleashing market forces and relying on constituent self-determination. (Please see: Exhibit A; Exhibit C, pp. 3-6, and its Appendix B, pp. 9-20.)

Impact of Technology on Market Data Use - The phenomenal growth of consumers' use of market data is part of the "democratization" of investing made possible by the huge drop in the cost of technology, manifested by the general communications explosion, including cable TV and the internet. At the end of 1998, 34 million consumers owned stocks directly, and another 50 million invested through mutual funds and other vehicles.

The Exchange facilitated this democratization by enabling the real-time broadcast of market data on cable TV in 1996 and through pilot programs for market data fees in the early 1990s that allowed broker-dealers and market data vendors to experiment with non-traditional bases for paying for market data. In 1999, we codified the most successful of the pilot programs. (Please see Exhibit C, pp. 11-13, and its Appendix D, pp. 4, 13-17, and its Appendix E, pp. 6-8.)

Funding of SROs in Part by Market Data Fees - For at least 75 years, market data users have shouldered about one-fifth of the costs of operating the Exchange through market data fees. But market data fees, taken together with transaction fees, have never come close to covering the cost of operating the Exchange's market and making the investments in our technical infrastructure necessary to maintain and enhance their operating stability. Listing fees have covered the difference. Listing fees have also made up the difference between the costs of regulation and the revenue from regulatory fees, although fees levied on Floor members introduced at the beginning of this year have moved regulation even closer to self-funding. **(**Please see Exhibit A; Exhibit B, p. 2; Exhibit C, pp. 13-15, 21, and its Appendix D, p. 8.)

Regulatory Impediments to Improvements - The key regulatory issues surfaced by the Seligman Committee pertain to the SEC requirements that SROs consolidate and jointly disseminate market data and that vendors and that broker-dealers display all markets' data. The core debate within the committee turns on the tension between (1) removing these requirements as a means of introducing sufficient SRO competition into the arena to address cross-subsidies and to further discipline pricing and service and (2) concern that both the quality of the data and the general availability of all markets' data would be impaired. (Please see Exhibit C, pp. 19-22.)

Transparency of Market Data Terms and Conditions – While more may need to be done, I note that:

- The dissemination of market data occurs under the pervasive oversight of the SEC, including attendance by the SEC staff at consortium meetings.

- The SEC publishes amendments to the joint venture agreement and fee changes in the Federal Register for public comment.

- Give-and-take among market data users at the SRO boards determines pricing decisions and other key matters.

- The ongoing contact between the Exchange staff and market data vendors and users, and the staff's participation in industry groups, give rise to fee changes and other initiatives.

- We publish all of our fees, as well as our principal contract forms, on our public web site.

- We file audited consortium financial statements with the SEC, from which they are available.

- Each SRO publishes and widely disseminates an annual report that includes audited financial information.

(Please see Exhibit C's Appendix E, pp. 9-11.)

* * *

I hope the foregoing is helpful to the Subcommittee. We look forward to working with the House Financial Services Committee on issues affecting the capital markets.

Thank you again for the opportunity to present this testimony. I would be happy to answer any questions that you may have.

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Exhibit A

February 8, 2001

Re: Market Power in Pricing Market Data

Dear Members of the SEC Advisory Committee on Market Information:

During our December 14 meeting, several participants discussed the issue of "market power" as we move to a competitive market data landscape. Others voiced questions about the governance of the SRO consortia. It occurred to me that some of the comments might reflect an understandable lack of knowledge of the business history of CTA in particular, and of the governance process of CTA and its SRO participants.

As one of two dozen meeting participants, I did not want to take up others' time in making clarifying comments. Thus, I am writing now. Since the history, structure, corporate form and governance of CTA and the NYSE differ significantly and relevantly from those of the OTC/UTP dissemination and NASD/NASDAQ, I confine my remarks to CTA and the NYSE.

Any concern that the NYSE could and might exercise market power in a competitive environment for market data ignores 75 years of evidence to the contrary. It also ignores the discipline that derives from the constituent nature of NYSE governance. Moving to a competitive model will not relax that discipline.

NO EVIDENCE OF THE EXERCISE OF MARKET POWER

If the NYSE (or CTA) were exercising market power in the pricing of market data, one would expect, for example, a history of price increases. Yet, to the contrary, the prices for NYSE/CTA market data services have either declined or remained unchanged since the mid-1970s. That helps to explain why the cost of CTA market data has declined 81 percent over the past 15 years. That result is wholly inconsistent with the hypothesis of a dominant entity exercising market power.

Market power might also manifest itself as a rising contribution of market data fees to NYSE revenue. In fact, the proportion has oscillated between 15 and 17 percent since CTA's creation. That proportion long precedes the advent in the mid-1970s of both the CTA consortium and the SEC's oversight of market data fees: we have traced it back to the 1930s.

If there is latent market power, then something is disciplining its use.

USERS LEVY FEES ON THEMSELVES

The source of this discipline is no mystery. The NYSE does not so much establish prices as allocate costs. Constituent representatives establish NYSE prices by first determining the NYSE's funding needs, and then allocating the resulting costs among themselves.

Twenty-four men and women long experienced in business and the public sector -- 21 who are CEOs of users of Exchange services and three who are Public Directors with no financial interest in the outcome -- determine the Exchange's funding. They then allocate most of the non-regulatory costs of running the Exchange between listed companies and member broker-dealers (with institutional investors and other non-members contributing the balance) by establishing fees denominated as "listing fees", "transaction fees" and "market data fees". If they change the allocation, it must withstand scrutiny by constituent proxies -- Board representatives of potential "winners" and "losers" in the reallocation -- as well as by the Directors representing solely the public interest.

Board action is the last stop in our constituent process. Before the Board reallocates any costs, Exchange staff vets the proposed change with user groups. In the case of market data fees, the process includes our daily interaction with brokers (and vendors) in the course of our providing services to them, as well as our ongoing participation in industry associations. The NYSE staff seeks consensus by discussing new fee ideas with constituents who advocate their varying business models.

That this mechanism produces a fair result does not surprise economists. Through their proxies, the consumers of a complex, interdependent set of services determine what they pay. Congress recognized that this kind of competition among users produces the best and fairest allocation of costs: in 1975, it wrote into the 1934 Act requirements that exchanges afford fair representation of brokers, issuers and investors and fairly allocate costs among them.

Were the "belt" of constituent cost allocation ever to break, the SEC review process provides "suspenders". However, in the 26 years since Congress authorized the SEC to regulate market data fees, only once have the "suspenders" come into play -- not because of a ***failure*** of fair allocation, but because of a single user's campaign to ***avoid*** it.

I did not mention CTA in describing how costs are fairly allocated. This reflects reality. The SROs have never delegated fee matters to CTA: the SRO boards decide fee matters directly.

*   *   *

To be sure, adopting a competitive model will bring market forces to bear on market data pricing. But the primary discipline on any latent market power will remain the same: our constituents allocating the costs of running the Exchange among themselves. They arrive at fair allocation, not because of a statutory mandate or altruism, but because of the give-and-take among their Board representatives. These representatives recognize that their firms all benefit from funding the Exchange -- and that each user must contribute its fair share.

Simply put, those who approve the Exchange's budget and market data (and other) fees are the ones who pay. They can raise or lower any fee -- thereby reallocating among themselves the costs of operating the Exchange -- any time they want.

I hope the foregoing is helpful to you as the Committee pursues its important work.

Sincerely yours,

/s/ Robert G. Britz

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cc: Annette Nazareth
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Exhibit B

December 1, 2000

Mr. Joel Seligman
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Re: Competing Consolidators Model

Dear Dean Seligman:

By your October 26 email to the members of the SEC Advisory Committee on Market Information, you requested that members who have ideas for alternatives to the current "consortium consolidator" model describe their ideas in writing. By this letter, the New York Stock Exchange responds to your request. We describe below how a model involving competition among multiple, non-exclusive consolidators (the "competing consolidators" model) might work.

First, we explain why we believe the competing consolidators model is a better way to address the problems with the consortia than the proposals in the SEC's concept release on market data.(1) We then provide an overview of how the competing consolidators model might work. In the balance of this letter, we respond to the specific questions (somewhat re-ordered for the sake of logical progression) that you posed in your October 26 email.

INTRODUCTION

As we described at length in our submission responding to the SEC's concept release on market data,(2) over the last 25 years, CTA/CQ has established a solid track record of making a high-quality data service ubiquitously, inexpensively and reliably available to securities professionals and consumers. As we also pointed out, we believe that, because proposed CTA/CQ fees are vetted with the industry, approved by the constituent governance processes of the nine exchanges[(3)], and subjected to SEC review and public comment, the market data revenue that the NYSE receives reflects a fair allocation of the NYSE's costs. In short, it is not at our initiative that we propose to end our joint effort with the other exchanges, any more than it was at our initiative that we began that joint effort in the first place.

But the concept release's proposals to add additional layers of bureaucracy and to embrace a utility ratemaking model, as well as the growing dysfunction of CTA/CQ in the face of evolving market structure, led our Board last April to determine that we should withdraw from the CTA/CQ Plans. We are confirmed in our course by the subsequent crystallization of the legal perils of joint activity even when taken within the framework of an SEC-approved plan,[(4)] and by the contradiction between continued joint dissemination and the prescription by the Antitrust Division and the SEC that each exchange must acquire and manage its own data transmission capacity independently.[(5)]

Our decision recognizes that technology and market forces provide a workable way for the NYSE and the rest of the industry to assure the display of consolidated data after the NYSE's exit. It also recognizes that we have the right under the CTA/CQ Plans to withdraw so long as we demonstrate to the satisfaction of the SEC that we will continue to meet the requirements of the applicable SEC rules.

But, to be clear, the NYSE is not calling for the abolition of CTA/CQ. Nor do we believe our withdrawal will trigger any crisis in data consolidation and dissemination. Similarly, we are not trying to promote a new market data distribution model for the industry, which would be both presumptuous and well beyond our ambition to exit CTA/CQ.

Nevertheless, we recognize that, by definition, our withdrawal will create the potential for multiple consolidators for the securities we list, and will somewhat alter the market data landscape. We also recognize that our action will create a template that other exchanges may wish to use or extend. That could change the market data landscape more significantly.

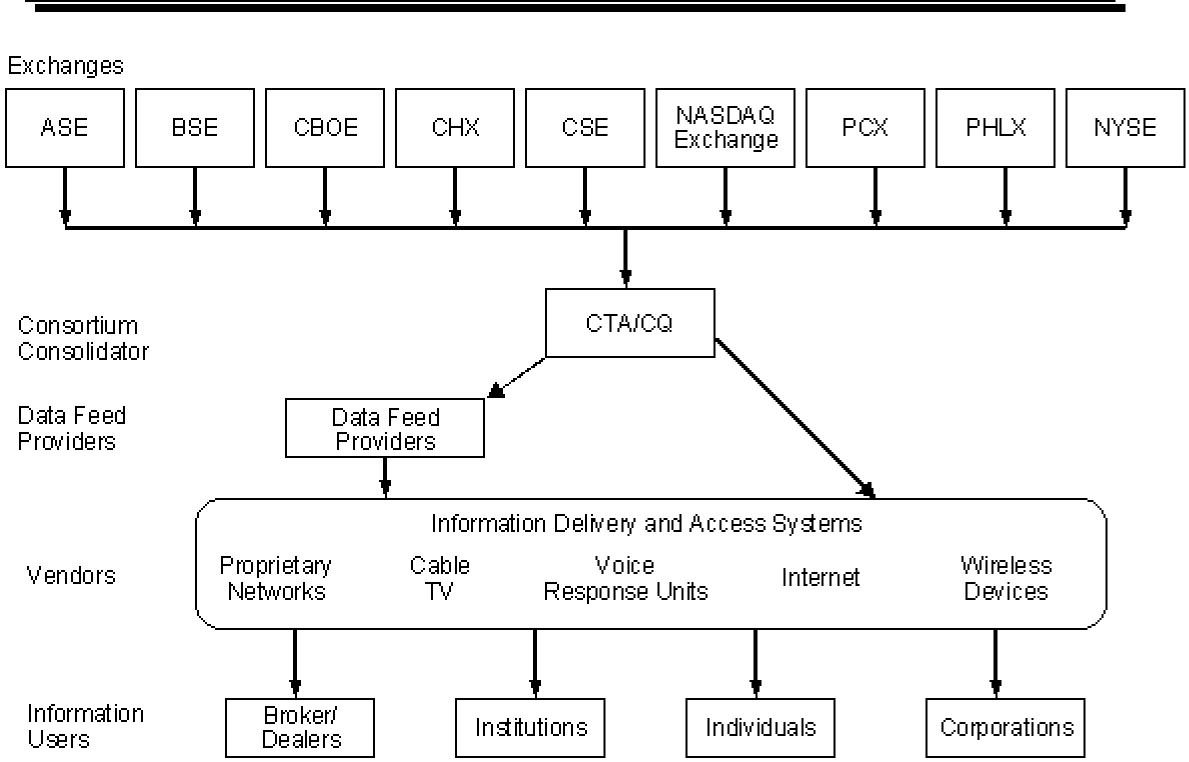
While the NYSE is not advocating any particular model for the industry, we have thought through what the market data industry structure might look like following our withdrawal from CTA/CQ. In response to your request, we are pleased to share our thinking with the Committee.

OVERVIEW

Current Model (Consortium Consolidator)

Under the CTA/CQ Plans, the nine exchanges (1) establish and collect common charges, (2) jointly enter into and administer contracts regulating the terms of receipt of last sale prices and quotation information and (3) oversee a common processing and data distribution facility. The nine exchanges select an exclusive processor to operate their common data facility.[(6)] For the purposes of this letter, the consortium processor's functions may usefully be delineated as three: (1) collecting each of the nine exchanges' data output (the "single-exchange data feed function"), (2) consolidating the nine exchanges' data (the "consortium consolidation function") and (3) providing a consolidated data feed to anyone who wishes to avail itself of it (the "consolidated data feed function"). Diagram 1 shows the current data distribution arrangement.

Diagram 1 - Consortium Consolidator Model



As is depicted in Diagram 1, the CTA/CQ consortium processor provides a consolidated feed directly to 62 entities that can be divided into two categories: (1) those that provide data feed services to others (depicted as "Data Feed Providers" in Diagram 1) and (2) those that solely service end-users or their own internal use (depicted as "Vendors" and "Information Users" in the diagram).[7] The 62 direct recipients comprise eight exchanges, three press organizations, 18 vendors and 33 broker-dealers**.** Most of the 18 vendors (Bridge, ILX, Reuters, S&P Comstock, etc.), as well as a few broker-dealers, offer data feed services. These services typically supplement the consortium feed with consolidated options and OTC stock data, as well as data from domestic futures exchanges and from non-U.S. exchanges.

In addition, approximately 1400 vendors and information users receive consolidated data indirectly, through one or more of the data feed providers. For the most part, these indirect recipients are broker-dealers, institutions and others that redistribute data internally to their employees and, more recently in the case of broker-dealers, to their retail customers.

Competing Consolidators Model

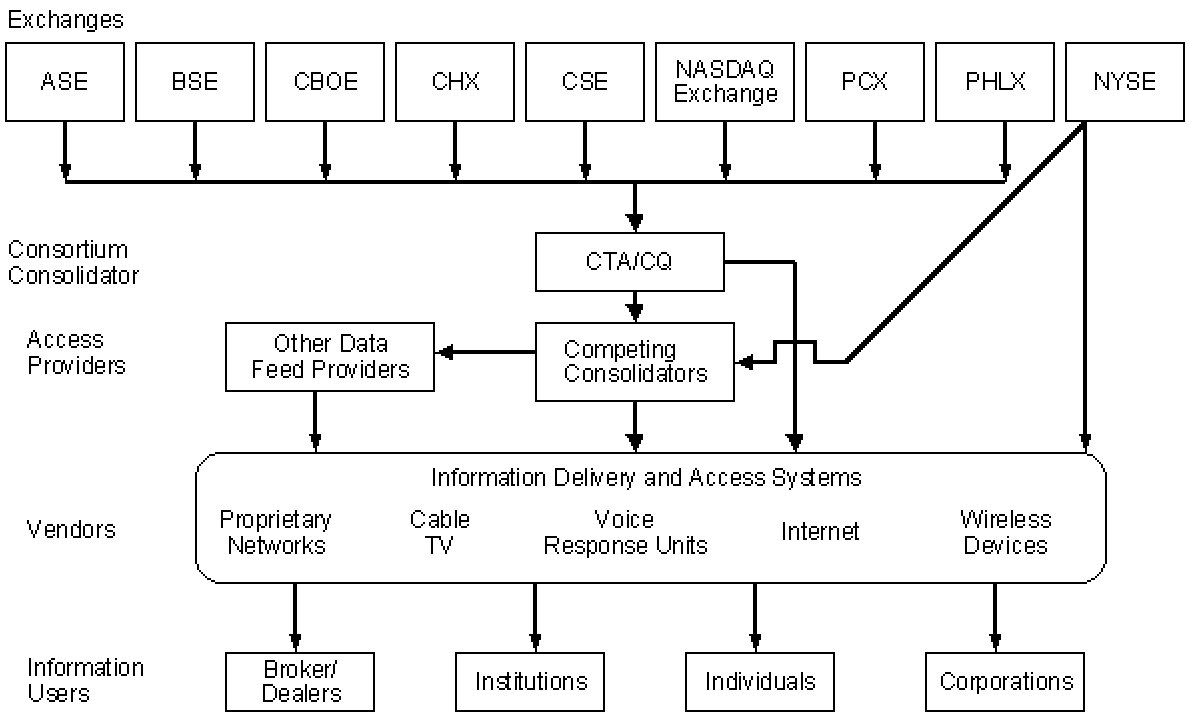
The competing consolidators model unbundles several functions currently performed at the consortium level. Upon the NYSE's withdrawal from the CTA/CQ Plans, the NYSE would (1) separately establish and collect its own fees, (2) separately enter into and administer its own contracts regulating the terms of receipt of its last sale prices and quotation information and (3) provide its own data distribution facility. The NYSE will use the services of SIAC (its data processing subsidiary) to operate this NYSE-only facility. However, its facility would only perform the single-exchange data feed function. Diagram 2 illustrates this revised arrangement.

As depicted in Diagram 2, to disseminate consolidated data, direct data feed recipients would have to:

• Take two data feeds - the consortium feed (which no longer includes NYSE data) and (2) the NYSE-only feed, and

• Perform the consolidation function and the consolidated data feed function.

Diagram 2 - Competing Consolidators Model



Any data feed provider (including SIAC[(8)]) or other data processing firm could enter this non-exclusive consolidation business. (Such data feed providers and firms are separately delineated as "Competing Consolidators" in Diagram 2.) Any data feed provider that does not enter the consolidation business, as well as any of the other 62 direct recipients that choose not to enter the consolidation business, would have to contract to receive consolidated data from a competing consolidator.

Similarly, any of the 1400 indirect data feed recipients that does not wish to avail itself of the consolidation services provided by the competing consolidators could choose to self-consolidate (depicted in Diagram 2 by the arrows from CTA/CQ and from the NYSE that bypass the competing consolidators box). The rest of the indirect recipients would continue to receive consolidated data feeds. Professional and nonprofessional subscribers (depicted in the diagrams as "Information Users") would also continue to receive consolidated data services.

Appendix A traces the flow of data from the input of an order into the NYSE systems through display under the competing consolidators model.

Extended Competing Consolidators Model

The model also works if other exchanges -- or all exchanges -- withdraw from the CTA/CQ Plans. We anticipate that it would also work if they withdraw from the OTC/UTP Plan and the OPRA Plan as well (in which case consortium consolidation would disappear altogether). Diagram 3 illustrates the model as extended to all CTA/CQ exchanges. Note that the schematic is actually simpler than that of Diagram 2, since the consortium consolidator box (CTA/CQ) disappears altogether.

Comparative System Costs

Most of the costs of market data are internal to the nine exchanges, taking the form of developing, deploying and operating the technical infrastructure to support the production and dissemination of the data. The competing consolidators model implies no changes to these costs. However, the NYSE's withdrawal would affect the portion of the dissemination costs that are currently pooled.[(9)]

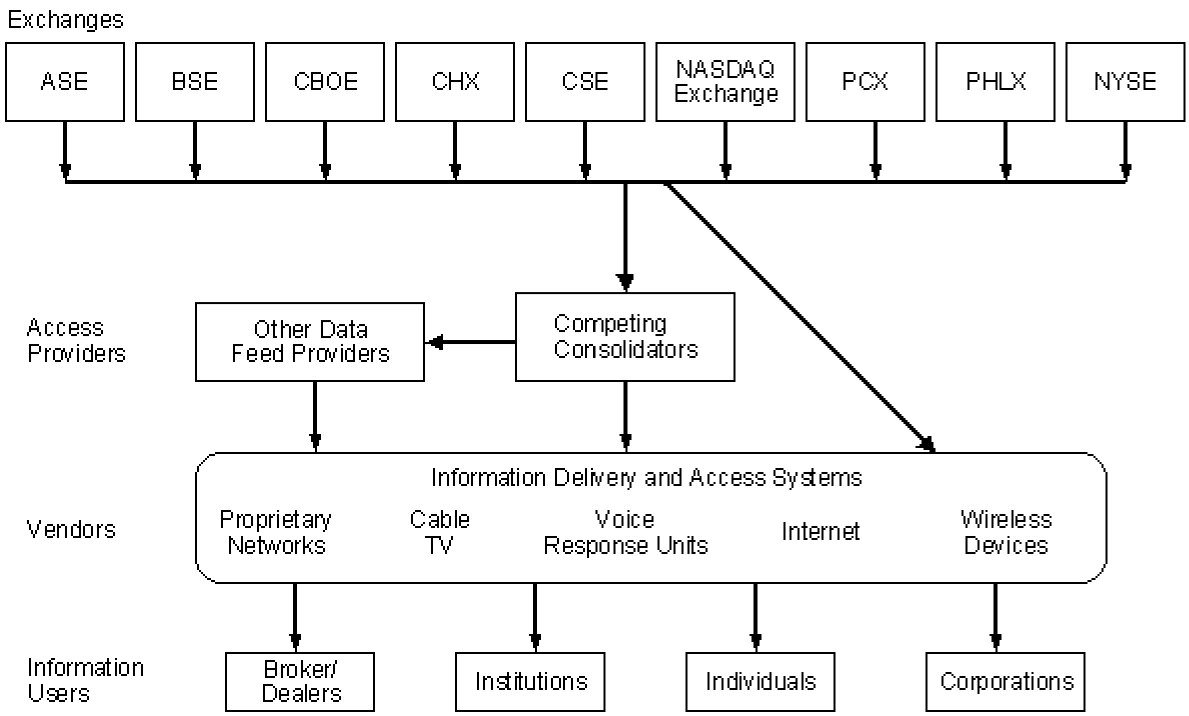
The nine CTA/CQ exchanges currently share the approximately $6.6 million in costs annually incurred by the consortium consolidator in providing the single-exchange data feed functions, the consolidation function and the consolidated data feed function. While these costs are tiny when compared to the overall costs of the market data industry, we believe these costs could well decrease, at least under the extended competing consolidators model.

Under the extended model, each exchange would incur the cost of its single-exchange data feed function individually, and competing consolidators would take on the costs of the consolidation function and the consolidated data feed function.

• **Single-Exchange Data Feed Costs** - Predicting the outcome as to the costs of the single-exchange data feed functions under the extended model is highly speculative since each exchange would, for the first time, independently enjoy a variety of insourcing and outsourcing alternatives that would tend to drive costs down. However, one can bound the costs at the upside by observing that, if the NASDAQ Exchange simply used its existing data processing facilities and the other exchanges simply continued to use SIAC for this purpose, these costs would change little.

• **Consolidation and Consolidated Data Feed Costs** - As noted, the competing consolidators model will completely subject these aspects of the dissemination system to market forces. Moreover, among most likely entrants into the competing consolidators business are the existing data feed providers, which already process the consolidated feed (i.e., they would require little incremental capacity); already handle scores of data feeds from the consortium consolidators, the several domestic futures exchanges and exchanges around the world; and already provide data feed services to 1400 vendors, broker-dealers and others. Thus, it is unclear whether they would have material incremental costs in taking on the consolidation function. As a result, the extended model might take the portion of the $6.6 million attributable to consortium consolidation and consortium consolidated data feeds completely out of the overall system, rather than merely shifting them from the consortia to the consolidators.

Diagram 3 - Extended Competing Consolidators Model



RESPONSES TO QUESTIONS

Who will act as competing consolidators?

Under the competing consolidators model, neither SIAC nor any other entity would serve as the exclusive source of consolidated trades and quotes. Instead, any entity could pick up the consortium and NYSE data streams, consolidate the streams and make the resulting consolidated stream available to vendors, broker-dealers and investors.

The broad universe of possible non-exclusive consolidators includes current industry participants (i.e., SIAC and the data processing subsidiaries of other exchanges, as well existing data feed providers). The non-exclusive, competing consolidators would compete to provide consolidation services, just as they compete today to provide data feeds.[(10)]

How will competing consolidators obtain market information?

Today, SIAC and the nine exchanges install lines by which each exchange sends its trades and quotes to SIAC for validation, consolidation and dissemination. Pursuant to the CTA/CQ Plans and bilateral contracts, SIAC acts as each exchange's agent in this activity. It neither enters into contracts with, nor collects fees on, the vendors, broker-dealers and others that gain access to the consolidated data from SIAC. Instead, the exchanges compensate SIAC for its work from the pool of revenues that they jointly collect from data users.

Under the competing consolidators model, CTA/CQ would provide the consortium feed (no longer including NYSE data), and the NYSE would provide the NYSE-only feed, to the competing consolidators and to vendors, broker-dealers and others that self-consolidate. As CTA/CQ does today, the NYSE would use IP multicasting protocols (or comparable distribution mechanisms) and require consolidators to receive the data over at least a T1 communications line (thereby minimizing any latency delays that might result from lower line speeds).[(11)]

How will competing consolidators make market information available to users?

Competing consolidators would provide consolidated data to the approximately 1400 broker-dealers, institutions and other indirect data feed recipients in the same way that that they provide data feed services today. In turn, the indirect data feed recipients would disseminate consolidated data to end-user devices in the same ways as they do today.

How will brokers satisfy their best execution responsibilities under the competing consolidators model?

As noted, the competing consolidators model would make no change in the ability of end-user devices to continue to receive consolidated data. Thus, the model implies no change in the manner in which brokers satisfy their best execution responsibilities and, in particular, in the availability of the NBBO and the other consolidated data necessary to comply with the recently-adopted rules on disclosure of execution quality.[(12)]

How will terms, including fees, for information be determined?

Each competing consolidator would administer its own business. It would assume responsibility for assuring that it has sufficient capacity to receive and process all nine exchanges' data streams. It would also establish its own charges for its creation and provision of a consolidated feed under competitive conditions, just as data feed providers charge for the services they offer today. Thus, we answer this question from the perspective of terms that the NYSE is likely to establish after withdrawal.

Terms other than fees - Today**,** the market data consortia disseminate data under three sets of contracts.[(13)] Under the competing consolidators model, both CTA/CQ and the NYSE could continue to establish terms and conditions through contracts.[(14)] They simply would not do so jointly.

Thus, CTA/CQ and the NYSE could separately enter into a contract with each consolidator, other data feed provider, vendor and professional subscriber.[(15)] Each contract would establish terms and conditions that are fair and reasonable and not unreasonably discriminatory.[(16)] Contracts with competing consolidators and self-consolidating vendors might include technical specifications.

Fees - As noted above, today, the nine exchanges establish fees jointly though a multi-layered process that involves vetting fee proposals with customers and industry groups, approval by each exchange's constituent finance committee or board, approval by CTA/CQ, and SEC review (including an opportunity for public comments). Under the competing consolidators model, except for the consortium-approval step, the process would be the same for the NYSE. Thus, the NYSE would establish its fees for NYSE-only data in the same way as it does today as to fees for listing, trading, regulatory and other services. Each fee would be subject to SEC review under the fair-and-reasonable and not-unreasonably-discriminatory standards noted above and the fee-filing requirements of Rule 11Aa3-2. The NYSE would bill its customers and collect amounts due.

Should market information be made available in a standardized format? If so, what should that format be? How will investors be assured of receiving accurate, real-time consolidated information under the competing consolidators model?

While today's technology permits multiple entities to receive simultaneously multiple streams of data and to create consolidated outputs that sequence prices and quotes in the same order, a multi-consolidator environment will introduce at the consolidation level four types of risk that are present today among data feed providers, vendors and other recipients.

• **Different Consolidator Operating Environments -** Hardware, software and line differences could cause differences in the ways consolidators process the CTA/CQ and NYSE outputs, which could lead to sequencing differences.

• **Validation -** Different validation tolerances would result in sequencing differences.

• **Capacity Considerations -** A particular consolidator might have insufficient capacity.

• **Protocols/Data Formats -** Consolidators would have to manage any differences between the CTA/CQ and NYSE in line protocols and data formats.

Today, the CTA/CQ Plans resolve many of these issues, and it would seem likely that those resolutions would carry forward without any intervention.[(17)] In addition, because the four types of risk are present today among data feed providers, vendors and other recipients, the industry is experienced in managing those risks. Moreover, continuing differences among competing consolidators in these risk areas would result in differences in service levels; one would expect these differences to self-correct under the discipline of market forces. However, to the extent that intervention is necessary,[(18)] it could be effected through standards-setting under the auspices of a trade group, through contractual undertakings and, if necessary, through direct SEC regulation of non-exclusive securities information processors ("SIPs").[(19)]

Why is the competing consolidators model preferable to the existing consortium model?

As noted above, our decision to withdraw from the CTA/CQ Plans is not based on any view that CTA/CQ has fallen short in delivering a high-quality dissemination service ubiquitously, inexpensively and reliably. Rather, it is based on the view that the "cure" to the consortium model that the SEC concept release and the options antitrust settlements prescribe is worse than the "illness" its critics perceive. Thus, we answer this question from that perspective.

Costs - The costs implied by the competitive model appear relatively small. As noted above, the joint costs of the collection, consolidation and dissemination functions are modest relative to the overall costs of producing and disseminating market data, and it appears that the unbundling of consortium costs may not raise them at all. Indirect costs could arise from failing to effectively manage the loss of today's "one-stop shopping" at a single consolidator that has a track record of high quality and cost-effective service and that acts as a neutral leader in the arena of setting standards and coordinating industry activity. But, as noted above, market forces and, if necessary, intervention in the area of standards can minimize this risk.

Benefits - In contrast, the benefits appear substantial. As described above, the competing consolidators model provides a data dissemination process that, operationally, is at least as good as that which exists today. In one stroke, the model ends joint pricing, and thereby the inter-exchange subsidies, cross-consortia fee distortions and other market distortions that currently exist.[20] Extended, it solves the problem in the OTC/UTP consortium resulting from the undifferentiated internal/inter-market systems of the NASDAQ Exchange[21] and the operational dysfunction now plaguing all the consortia.[22] The extended model also achieves the capacity independence among the exchanges sought by the Antitrust Division and the SEC.

Affirmative benefits include that the NYSE would compete with the other eight exchanges in the market data arena, just as its competes today with the other eight exchanges individually in attracting listings and liquidity. Similarly, data feed providers would compete as to consolidation services, just as they do today as to other services. The general benefits from competition in any industry are well understood, and need not be repeated here.[23]

***

I hope our description of how a model involving competition among multiple, non-exclusive consolidators might work, as well as our identification of some of its costs and benefits, proves useful. I look forward to discussing our proposal with you and the other Committee members at our meeting on December 14.

Sincerely yours,

Robert G. Britz

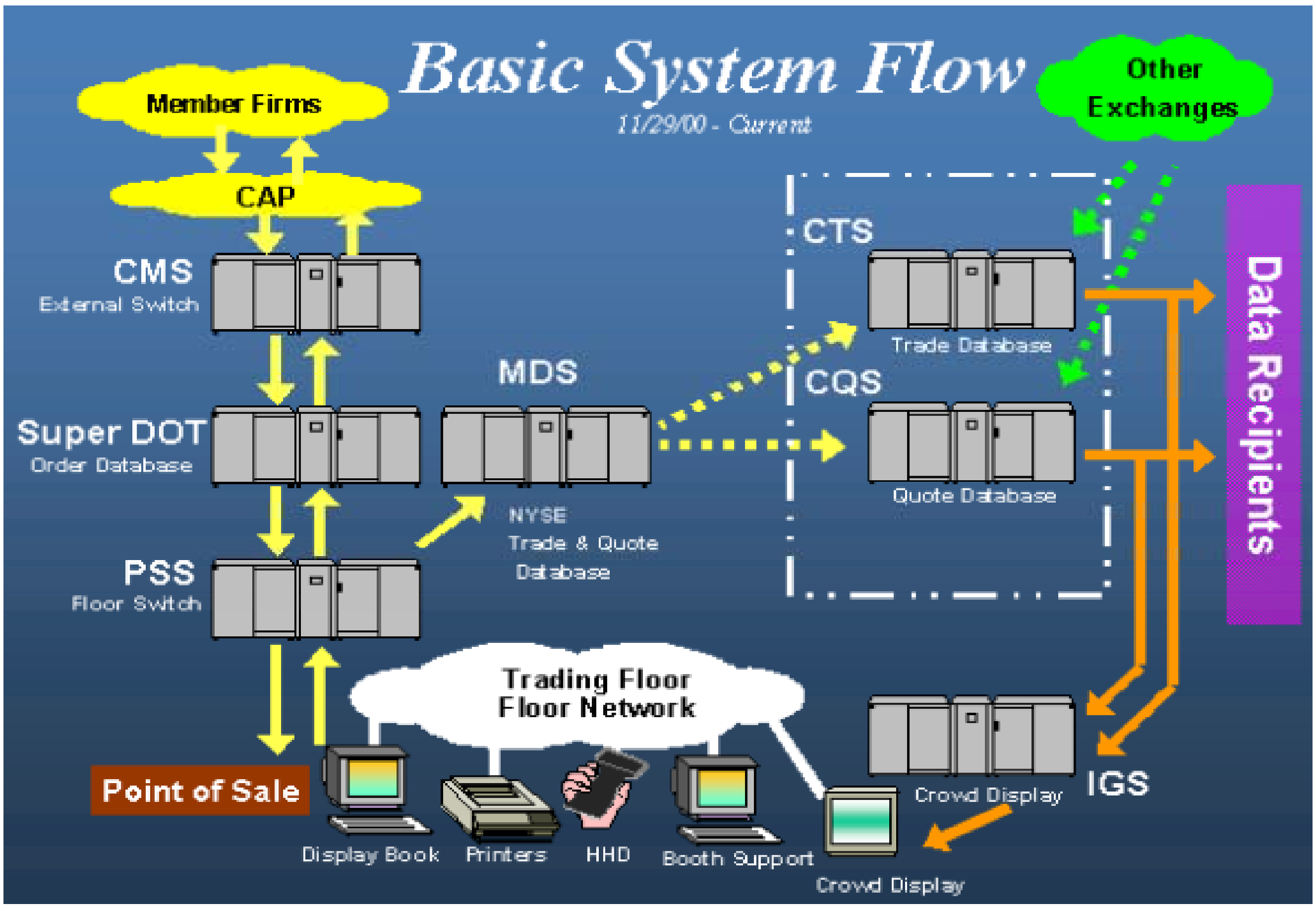
cc: Annette Nazareth
Members of the SEC Advisory Committee on Market Information

Appendix A

This Appendix A contains two flow charts. The first (Basic Systems Flow - Current) shows the current routing and processing steps of an order sent by a member firm to NYSE from the moment NYSE receives it to its distribution to data recipients and the attendant flow of market information that emanates from such orders. The second chart (Basic System Flow - Competing Consolidator) illustrates the modest changes that would occur in the routing of market information under the competing consolidator model.

Basic System Flow - Current *(See chart below)*

Beginning at the upper left-hand corner, member firms send orders to NYSE via the CAP network into CMS. CMS provides reliable communications between member firms and NYSE host systems operated by SIAC. CMS supports over 450 circuits, handling a variety of communications speeds and protocols. CMS receives, edits and validates orders and formats associated reports back to the member firms. CMS also handles queuing, flow control and priority routing. From CMS, the order flows to SuperDOT, where it receives a reference number and a "safe store" record created and placed in the database of record. Based on member firm parameters, SuperDOT then routes the order via PSS to its appropriate destination on the trading floor (which could be the specialist's display book ("DB"), a member's booth, a handheld device or the like).



Market orders received by DB are generally executed within a matter of seconds. When a trade execution occurs, DB sends a report of it back to the member firm and reports the details of the trade to MDS via PSS along with an update of the quotation. Limit orders entered into DB have the potential to generate a new quotation, which DB would also generate and send to MDS via PSS. MDS validates the trade and/or quote, captures it in a database and passes it on to CTS or CQS, as appropriate.

CTS and CQS receive trades and quotes from NYSE and from each of the eight other U.S. exchanges. These trades and quotes are validated, captured in databases, consolidated into two separate data streams (i.e., one for trade reports and one for quotes), and disseminated to data recipients via high speed networks.

IGS is a NYSE system that receives the CTS and CQS consolidated data streams just like any other data recipient. It then provides the data streams to NYSE applications such as crowd displays and booth support.

Basic System Flow - Competing Consolidator Model (See chart below)

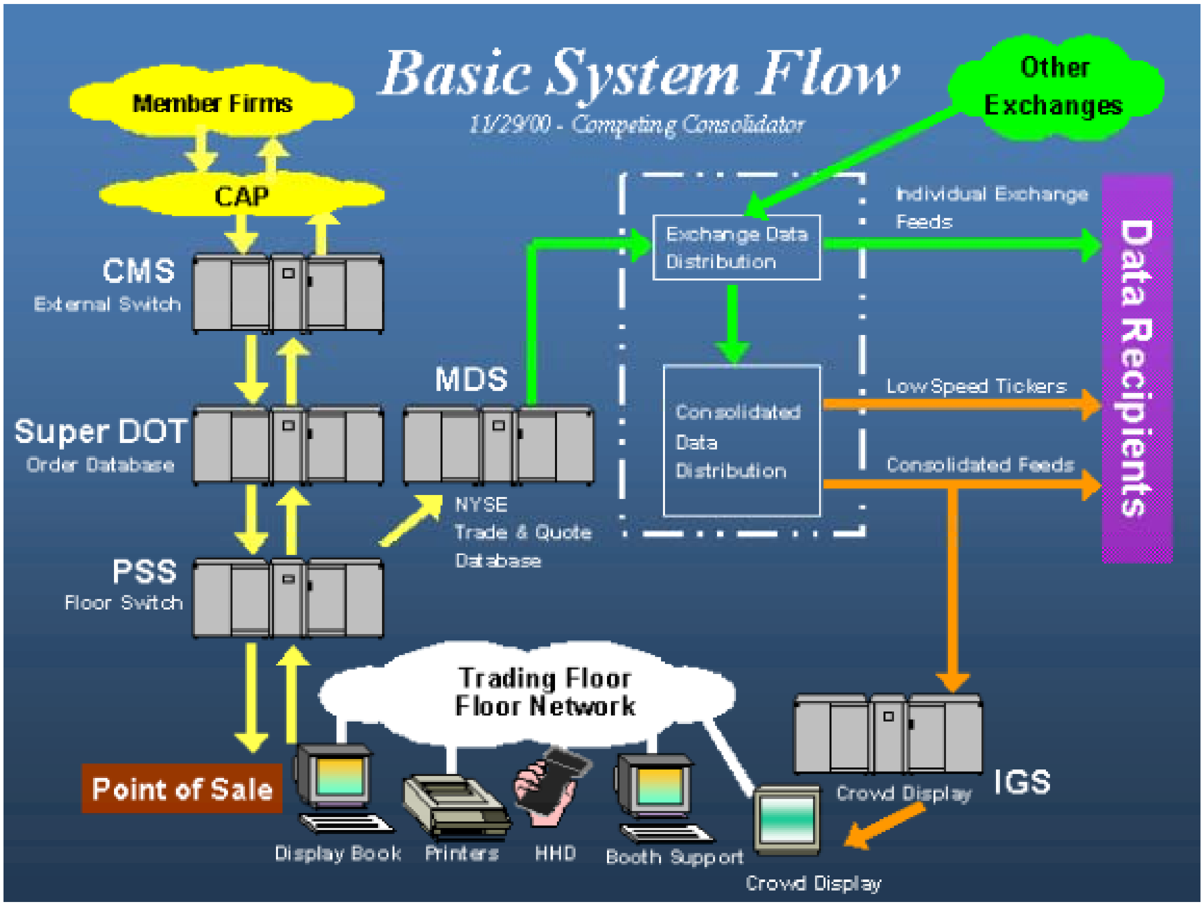
The left side of this chart is the same as previous chart. The channels through which member firms send orders to NYSE, and the several processing steps that are performed by NYSE host systems in handling those orders, remain unchanged in the competing consolidator model. Similarly, the trade report and quote generation process also remains the same.

Under the competing consolidator model, NYSE would no longer make its trade and quote information available solely to one exclusive consolidator, but to as many self-consolidating data recipients and/or competing consolidators as might wish to receive it. Under the current model, data recipients have no choice but to receive a consolidated stream of data. Under the competing consolidator model they could choose to receive individual streams of data from one or more exchanges and to consolidate those data streams themselves or they could choose to receive a consolidated stream of data from any competing consolidator.

NYSE anticipates that it would continue to support SIAC providing a consolidation facility, but not an exclusive processor facility. NYSE, as well as the other exchanges, will have a continuing need to receive and display data from all markets in order to fulfill their regulatory obligations. The chart below illustrates the making available of both unconsolidated and consolidated streams of data.

The box on the chart entitled "Exchange Data Distribution" depicts the output of unconsolidated streams of data received from any other exchange that wishes to distribute its data on an unconsolidated basis. It also reflects the fact that, even if an exchange chooses to utilize another facility to distribute its data, NYSE would, of necessity, make appropriate arrangements with all exchanges to receive their data and to consolidate such data for its own purposes.

The box on the chart entitled "Consolidated Data Distribution" reflects SIAC's continued performance of the consolidation function on a nonexclusive basis for NYSE and for the benefit of any other data recipient that might wish to receive a consolidated feed from SIAC.The functions depicted in both of these boxes could potentially be duplicated by



a number of other organizations. Each would receive trades and quotes from NYSE and from each of the other exchanges, and each would provide to data recipients (1) separate feeds consisting of each exchange's data (e.g., a NYSE-only feed), (2) a consolidated stream of last sale prices and/or (3) a consolidated stream of quotes.

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1. Release No. 34-42208 (December 9, 1999).

2. See "Comments to Securities and Exchange Commission Concept Release on 'Regulation of Market Information Fees and Revenues'" (April 10, 2000; the "NYSE Concept Release Response") at pp. 11-13 and Appendix D.

3. For the sake of simplicity, in view of NASDAQ's anticipated registration as a national securities exchange, this letter generally does not address the continuing role of the NASD in reporting internalized executions and other off-board trades.

4. Recently-settled proceedings of the Antitrust Division of the Department of Justice and the SEC alleged that a decision taken by the Amex, CBOE, PCX and PHLX to limit the capacity of OPRA effectively constrained multiple trading in certain options classes. *United States v. American Stock Exchange et al.*, No. 1:00CV02174 (D.D.C. filed Sept. 11, 2000), Complaint at 10; *In the Matter of Certain Activities of Options Exchanges*, AP File No. 3-10282, Exchange Act Release No. 43268 (Sept. 11, 2000), Order

Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions at 4, 6.

5. The settlement in the options antitrust matter imposed the prescription on the Amex, CBOE, PCX and PHLX. See *United States v. American Stock Exchange et al.*, Competitive Impact Statement of United States at 21. At the May 10, 2000 CTA meeting, the SEC staff requested that the constituent exchanges file amendments to the CTA and CQ Plans that would meet this independent capacity standard as well.

6. Since the CTA/CQ Plans' inception, the constituent exchanges have contracted with the Securities Industry Automation Corporation ("SIAC") to act as the consortium processor.

7. Note that the diagram simplifies the market data industry by depicting as discrete several functions that are often combined within the same entity (e.g., a data feed provider typically also provides interrogation services to its own employees or customers). This simplification is not material to the changes suggested by the competing consolidators model.

8. Outside of its consortium role, SIAC becomes just one more data feed provider serving the information industry.

9. Note that we are focused in this section solely on a steady-state analysis of the system changes necessitated by the NYSE's withdrawal, asking whether proliferating the number of connections with exchanges and the number of consolidators implies the creation of repetitive facilities and, therefore, the incurring of increased costs. We address fees separately below.

10. While we have not generally assessed the interest of data feed providers in entering the competing consolidator business, SIAC has indicated its strong interest in doing do.

11. Under the "concurrent use" provisions of the CTA/CQ Plans, SIAC already performs single-exchange data feed functions on behalf of the several exchanges that make available through SIAC data that is not consolidated, e.g., index values and trades and quotes in local securities. In performing these single-exchange data feed functions, SIAC does not act for all nine exchanges collectively, but solely for the exchange whose data it processes. SIAC is compensated for providing those bilateral services under the general arrangements of the CTA/CQ Plans. (As noted above, SIAC will perform the single-exchange data feed function on behalf of the NYSE.)

Any other exchange withdrawing from any of the consortia would have to either create its own capability to make its data available to consolidators or enter into bilateral arrangements with a data processing firm to provide a feed of its data to consolidators. While we have not generally assessed the interest of data processing firms in performing this function, SIAC has indicated its strong interest in doing so.

12. Rules 11Ac1-5 and 11Ac1-6. The question of whether to continue to require vendors and broker-dealers to provide consolidated data displays to all customers (rather than requiring them only to *offer* consolidated displays) deserves careful consideration by the Committee. However, the competing consolidators model works with either approach.

13. The three sets consist of one set under the CTA and CQ Plans, one set under the OPRA Plan and one set under the OTC/UTP Plan. Each set includes forms of agreement between each market and the consolidator, between the exchanges and vendors, and between the exchanges and professional subscribers. It also includes a form of nonprofessional subscriber agreement which, under the CTA/CQ Plans, runs between the subscriber and the vendor acting on behalf of the nine exchanges. The NYSE expects to continue this approach as to NYSE-only data.

14. Under the competing consolidators model, the NYSE would have to receive SEC approval of its own transaction reporting/national market system plan. (See Rules 11Aa3-1 and 11Aa3-2.)

15. Under the extended competing consolidators model, the resulting change from joint contracts to individual exchange contracts could theoretically result in an increase from today's three sets to nine (11, taking into account the NASD and the International Securities Exchange, which is the sole options exchange that is not also a CTA/CQ Plan participant). However, if the industry's experience regarding the high level of conformity among the exchanges' rule books is predictive, those three sets would serve as models for all the exchanges, and the regional exchanges would tend to follow subsequent modifications to the three sets that the primary exchanges make.

16. See 1934 Act sections 11A(c)(1)(C) and (D).

17. If the NYSE were the only exchange to withdraw from the CTA/CQ Plan, uniform standards would almost certainly prevail so long as SIAC remained the consortium processor.

18. For example, data feed providers currently manage protocol and data format differences in receiving feeds from the several data consortia, from the several domestic futures exchanges and from scores of exchanges around the world. On the other hand, we think that the issue of validation differences would almost certainly have to be addressed through uniform standards.

19. The SEC has the authority to regulate non-exclusive SIPs under 1934 Act section 11A(c). It uses this authority to require consolidated displays. (See Rule 11Ac1-2.)

20. SEC Market Data Concept Release, p. 34; NYSE Concept Release Response, pp. 3, 20-21 & 37. In brief, the joint activity under the plans distorts pricing and market efficiency because it creates (1) a revenue sharing scheme that ignores the value of each market's data (i.e., it creates inter-exchange subsidies) (see pp. 3, 20 and 21 of the response); (2) disincentives to quote competition (see pp. 20-21 of the response); and (3) cross-plan fee distortions (i.e., Network A receives 23 cents per message; Network B, $1.69) (see p. 37 of the response).

21. See generally Letter dated October 17, 2000, from Robert G. Britz, Group Executive Vice President, New York Stock Exchange, to Richard G. Ketchum, President and Chief Operating Officer, NASDAQ Stock Market (the "October Letter to NASDAQ"). We have attached a copy of the October letter, which included the NYSE Concept Release Response as an exhibit, as Attachment A to this letter.

22. October Letter to NASDAQ, p. 2 & n. 6; NYSE Concept Release Response, p. 21 & n. 37.

23. Indeed, it seems to us that the consortium model can no longer be sustained as a regulatory matter. A core principle of the 1934 Act is that exchanges may not act in a way that imposes any burden on competition not necessary or appropriate in furtherance of the purposes of the 1934 Act. (See, e.g., 1934 Act section 6(b)(8).) In the face of the workable, pro-competitive alternative that today's technology makes possible, it is not clear to us how those who might espouse continuing today's consortium model could demonstrate that the burdens on competition imposed by the consortium model continue to be "necessary or appropriate". Thus, when subjected to the criteria of the 1934 Act, the question that you pose must be reformulated as, "What benefits of the consortium model over the competing consolidators model justify the burdens on competition created by the consortium model?"

New York Stock Exchange, Inc.

Comments to
Securities and Exchange Commission Concept Release on
"Regulation of Market Information Fees and Revenues"
(Release No. 34=42208; File No. S7-28-99)

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11 Wall Street
New York, NY 10005
212 656 2060

James E. Buck
Senior Vice President
and Secretary

NYSE
New York
Stock Exchange, Inc.

April 10, 2000

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, D.C. 20549-0609

Re: Market Data Concept Release (December 9, 1999), File S7-28-99

Dear Mr. Katz:

The Exchange wishes to thank the Commission for providing a forum for a serious discussion of a critical subject, and for providing us this opportunity to participate. Market data is our core product. When two investors trade, the *execution* is important to just them. But the *price* of the trade is important to millions of others around the world - for deciding their next market action, for pricing their portfolios, for valuing their stock options and for providing a report card on how well management is discharging its responsibilities to them as shareholders.

We are also eager to comment because we believe that the Concept Release raises issues well beyond market data - issues ranging from the basic governance, funding and operational stability of our securities markets to the neutrality of a self-regulatory organization ("SRO") toward different broker-dealer business models and the equitable allocation of costs versus "free-riding".

Below, we attempt to comment comprehensively on the substantive issues raised in the Release. However, we believe that it is equally important to place this discussion in its proper context.

The issue is not, nor has it ever been, about investors' access to real-time data for NYSE-listed issues. Professional investors have access to an endless supply of such data at a cost that, in real terms, has consistently and dramatically declined over the past 25 years. Indeed, we are not aware of any issue having been raised by users with regard to professional display unit fees for data made available by the markets that trade NYSE-listed securities ("Network A").

Similarly, individual investors, and the general public for that matter, have access to unlimited real time data through a wide variety of delivery systems - PC's, telephone, television, PDA's, pagers, automated teller machines, etc. Market data is available in the home and in public places - libraries, schools, airports, restaurants, train stations, shopping malls and literally on the street. In contrast to commentators who imply that investors are struggling for access to real-time data, in truth it is hard to avoid it. Simply stated, the data is pervasive and, from many sources, absolutely FREE.

So if this exercise is not about investors' access to market data, what is it about?

Well, it's about competitive positioning by brokers. It's about a few on-line brokers trying to gain competitive advantage by shifting to their competitors the cost of the markets' operations and infrastructure investments. It's about a broker-dealer business model that depends on access to (1) primary market-discovered prices on which to base internalized executions, (2) a deep pool of liquidity within which to lay-off proprietary positions, and (3) a network and order processing complex that provides unrivaled capacity and reliability - and that seeks to pay little or nothing for those services. Mostly, it's about trying to use the government to gain competitive advantage.

But there is another perspective, that of the markets that produce and distribute the data. From that perspective, the issues raised in the Concept Release are about governance - about the efficacy of self-determination within a SRO, where all constituents are represented and where majority rules. And the issues are about fair allocation of costs - about all users paying their fair share and not allowing some to "free-ride" while others pay more than they should. And the issues are about funding technical infrastructure investments needed to receive, process and safe-store the orders, quotations and trade reports that give rise to the data in the first place. Because under-investing in the capacity, redundancy and reliability of order processing systems is not an option for the New York Stock Exchange.

Today, the task of fairly allocating the costs of operating the markets among market constituents resides with the constituent boards of the SROs, subject to approval by the Commission after public comment. Cost allocation occurs pursuant to constituent governance procedures that the Securities Exchange Act of 1934 ("1934 Act") mandates, and that the Commission has approved and continually monitors. The Concept Release proposes to subordinate today's cost allocation by consensus to utility rate-making, and to overlay existing market governance with a new, supra-SRO bureaucracy.

In this letter and its appendices, we show how inserting the government directly into the fair allocation task will divert market resources, stifle productivity and innovation, increase industry costs, and significantly burden the Commission staff. In fact, in our opinion the proposal is simply unworkable. We also show how, in vitiating our constituent-driven process, utility rate-making will restrike the balance created by negotiation, compromise and consensus among our diverse constituents. Such a governmental intervention would thereby reallocate costs, produce "winners" and "losers", and favor one business model over another, all without providing measurable benefit to the investing public.

It is clear from the Concept Release that the Commission is concerned that the decision made in the 1970s to consolidate and disseminate market data pursuant to joint SRO plans produces revenue allocations to the regional exchanges and the National Association of Securities Dealers ("NASD") that do not relate either to the costs of running the regional and third markets or to the value of the derivative prices those markets produce.[1] The Exchange has long accepted that inefficiency as a price of achieving the statutory mandate of a national market system.

Now, the Commission seems committed to addressing the negative consequences of that decision. However, rather than create a new, supra-SRO bureaucracy coupled with utility rate-making, we propose that we eliminate the source of the problems -- the joint dissemination arrangement itself.

To catalyze a pro-competitive solution that takes advantage of today's technology, our Board of Directors has authorized our withdrawal from the CTA and CQ Plans.

ORGANIZATION OF SUBMISSION

To make this submission manageable for the Commission staff, this cover letter serves as an executive summary to a series of detailed appendices.[2] It is divided into three parts.

In Part 1, "Alternative Cost Allocation Models and Their Statutory Basis", we challenge the notion that the Commission staff has somehow been derelict for 25 years in failing to engage in rate-making. We maintain instead that the Commission has approached market data prices precisely as Congress contemplated, and in a manner which other regulators in other industries have come to recognize as vastly superior to traditional rate-making regulation. In Part 1 we also discuss the rate-making model presented by the Commission in the Concept Release, and describe the market distortions, costs and other pernicious effects it would produce, and the government micro-management of business processes it would entail.

Part 2, "The Track Record of the NYSE Board", begins by summarizing the many accomplishments under the Commission's 25-year stewardship of market data and clarifying some of the misconceptions that have arisen about the Network A fee structure. Then we discuss the extraordinary inclusiveness of the governance arrangements that prevail at the SROs today. We show that the constituent boards of the markets, through negotiation, compromise and consensus, demonstrate the verity of Winston Churchill's oft-quoted observation that "[D]emocracy is the worst form of Government except all those other forms that have been tried from time to time."[3] We also take a close look at a cost allocation decision that the Concept Release highlights - telephones and registered representatives ("RRs") versus PCs and the Internet - and show why none of the proposed alternative cost allocation models could reach a fairer result.

Finally, in Part 3, "Consolidation Technology, Free Markets and Constituent Boards", we review the inefficiencies which the Commission has identified as inherent in the current SRO joint ventures. We then argue that the solution lies in dissolving the ventures, harnessing technology and freeing the markets to compete in the market data arena as they do in all others. We further argue that market forces and the markets' constituent boards, under Commission oversight, would assure the fair allocation of market costs.

PART 1: ALTERNATIVE COST ALLOCATION MODELS AND THEIR STATUTORY BASIS

A. Congress Did Not Authorize a Market Data Rate-Making Process

As the Concept Release recognizes, Congress was not writing on a clean slate when it enacted the Securities Act Amendments of 1975 (the "1975 Amendments")[4]. The Commission had already approved the consolidated transaction plan filed by the

Exchange and the other markets during the previous year pursuant to newly-adopted Rule 17a-15 under the 1934 Act. That rule expressly provided that the SROs could impose "reasonable, uniform charges" for the distribution of market data. The CTA Plan extended to the consolidated networks the fee structures that had previously been in place for the ticker systems of the NYSE and the American Stock Exchange ("Amex").[5]

Because market data revenues were an established source of SRO funding at the time the 1975 Amendments were enacted, one must assume that any congressional intent to eliminate them, or to subject them to some type of cost-based justification process, would have been expressly set forth in the statute or in the accompanying legislative history. There is no evidence, however, that Congress intended such a result.

As set forth in the memorandum entitled "Legislative History and Subsequent Administration of Securities and Exchange Act Section 11A" (prepared by Debevoise & Plimpton and attached as **Appendix B**), the legislative history makes clear that the relevant provisions of Section 11A were designed to ensure that the Commission had clear statutory authority to address the types of problems that had delayed the development of a consolidated transaction reporting system over the previous three years. The Commission had been forced to referee disputes among the markets regarding many aspects of the consolidated reporting system, and the legislative history repeatedly cites the subjects of these disputes as examples of the types of problems that the rule-making authority provided to the Commission was designed to address. The fees charged for market data were not among the disputed items, and there is no indication that Congress sought to establish a standard more restrictive than the "reasonable, uniform charges" standard already in place under existing Exchange Act Rule 17a-15.

The Concept Release suggests that a congressional intent to subject market data fees to some type of cost-based justification process may be inferred from the fact that Congress referred to an exclusive processor of securities information as being "in effect, a public utility." It is clear from the context of the discussion in the legislative history, however, that this reference was in no way made for the purpose of explaining why market data fees need to be subjected to utility-type rate making proceedings: the reference was emphasizing the importance of ensuring that an exclusive processor functions in a manner that is "absolutely neutral" with respect to competing markets and firms. In short, Congress was concerned, not about the size of market data fees as such, but about the possibility that an exclusive processor might be dominated by a particular exchange and engage in practices that placed other markets or firms at a competitive disadvantage.

The conclusion that Congress was primarily concerned about non-price restrictions that would be anti-competitive or discriminatory, and did not intend to subject market data to a rate-making regime, is buttressed by the fact that Congress did mandate a cost-based justification process in another provision of the same legislation. In the context of eliminating fixed commission rates, Congress provided in Section 6(e)(1)(B) of the Exchange Act that the Commission could approve a schedule of fixed commission rates only if it made a finding that the rates "are reasonable in relation to the costs of providing the service for which such fees are charged." This illustrates that Congress knew how to write legislation that clearly requires a cost-based justification process when it intended to do so.

The Commission has administered the provisions of Section 11A for 25 years without subjecting market data fees to any sort of cost-justification process, except in the situation where an exclusive processor of securities information also acts as a vendor of that information.[6] The legislative history provides no basis for the Commission to abandon this long-standing policy and take a fundamentally different approach to the review of market data.

B. Distortions, Costs and Pernicious Effects of Government Utility Rate-Making

We are also convinced that the cost-based approach suggested by the Commission simply will not work. It would inappropriately burden both the government and the industry, stifle competition and innovation, and in the end, *raise* costs and, potentially, fees.

To assist us in analyzing the effects of the Commission's approach, we retained economic and regulatory experts at the consulting firm of PHB Hagler Bailly, Inc. ("PHB"). They have prepared two extensive analyses which support in depth our concerns about the fairness and viability of the cost-based approach. To enable the Commission and its staff to study these analyses in detail, we have attached them in their entirety as **Appendix C**.[7] For ease of reference, PHB has highlighted its findings in a cover letter, which we also include in Appendix C.[8]

The economists and rate-regulation experts at PHB make several points that we consider essential to any discussion of how to approach governmental involvement in the pricing of market data. To start with, they observe that the Commission has thoughtfully applied the mandate of the 1975 Amendments in overseeing the administration of market data production and distribution, and has beneficially regulated market data in a way that is currently the goal of many other regulatory bodies in other industries. In fact, PHB points out, other regulated industries *are actually moving away from cost-based rate-making.* The PHB experts are surprised to observe the Commission proposing to move *against the trend*,[9] and note that this can only be regarded as retrogressive.[10]

They see the Commission's proposal for "flexible cost-based" regulation as conceptually flawed and practically impossible. Simply put, they say there is no "short cut" like "flexible costing". Any cost-based regulatory scheme must be grounded on a thorough, rigorous analysis of the costs of all the markets supplying market data. Any such analysis requires the creation of a uniform system of accounts for deciding what to include and exclude. If some sort of "flexibility" is then introduced, it will only breed endless disputes as parties bicker over rate-making decisions based on a vague set of standards.

The PHB experts also observe that it is impossible to regulate market data prices in isolation from other prices charged by markets for other services. Market data and transaction execution are what the economists refer to as "joint products", linked in a way that pricing of one inevitably affects pricing of the other. If rate regulation were to reduce the revenues that could be realized from market data fees, then other fees - transaction fees or, in the case of the primary markets, listing fees - would have to be increased to maintain the same infrastructure and level of services. However, since the three types of fees fall differently on broker-dealers following different business models and differently on broker-dealers, institutional investors and listed companies, the result is a reallocation of market costs based, not on competition and constituent governance, but coming as a side-effect of governmental intervention.

In addition, PHB is able to speak with authority about the likely administrative burdens that cost-based regulation will place on all parties, especially the Commission itself. Extrapolating from what they observe in other industries, in PHB's expert opinion, the administrative burden would be "enormous". They note the large number of participants to be regulated. They describe the extraordinary amounts of information, accounts and reports that will have to be standardized and analyzed to make determinations that will stand the scrutiny and challenges to which rate-making decisions are subject.[11] And even when the preliminary work is diligently done, litigation is inevitable, if only to delay a decision unfavorable to one party or another. PHB also notes that rate regulation must allow the regulated entities to recover the administrative costs of regulation, adding to the costs that must be reflected in the rates charged for market data.

Cost-based rate regulation introduces other inefficiencies as well, and these inefficiencies equal additional cost. PHB observes from experience that cost-based regulation encourages cost-padding, and provides no incentive to reduce costs through operating or administrative efficiencies. Again, since the rates being regulated must themselves provide for recovery of related costs, this kind of regulation of market data prices will quite possibly lead to increases in those prices. Without a strong need to move to this form of regulation, such a result cannot be justified.

A very important point that PHB brings out in its analysis is that rate regulation is never aimed solely at minimizing rates to consumers, since very low rates may affect the attractiveness of the business to competitors and potential competitors, or the level of service provided. So the regulator must determine what is a "fair" rate of return that provides a suitable incentive for service providers while protecting consumers as well. Of course, this is what market competition usually does, and PHB reminds us that rate regulation implies a belief that market forces cannot be relied upon. As is clear from our comments, we strongly believe that constituent boards and customer control have in fact provided the discipline that any government would expect and desire in the area of market data services and fees, and that such inefficiencies as do exist arise from the decision to impose a joint venture arrangement for market data dissemination.

PHB also tells us that modern regulatory theory realizes that a more effective regulatory model is one that tries to mimic competition. This is the theory of "Ramsey pricing", which accounts for consumer welfare while meeting the need to keep the supplier viable. Most significantly, Ramsey prices cannot be deduced from cost data alone. In fact, prices for any one service are arrived at by assessing the elasticity of demand for that service, not by a simple accounting allocation of cost. The service with less elastic demand - market data, in our case - can be expected to bear a higher price compared with a service with more elastic demand - such as execution services. (See Appendix C-2.)

PHB's discussion of this concept is significant in two ways. First, it shows, contrary to the presumptions in the Concept Release and the arguments of certain commentators, that economic theory about cost-based recovery would shift the recovery of more of the market costs *to* market data fees and *away from* transaction and listing fees. Second, it prompts the question, "Why should government rate regulation, rather than constituent self-determination, dictate a shift among constituents as to how they bear the costs of the markets?"

In summary, we believe, and our experts confirm, that the cost-based approach suggested in the Release will inevitably stifle competition and innovation, and entangle both the industry and the Commission in time-consuming, expensive and ultimately fruitless proceedings and data analysis. PHB demonstrates that even in industries historically subject to utility regulation, cost-based rate making has been discredited. PHB also shows that market data dissemination is far from an ordinary utility function, and that cost-based regulation is particularly inappropriate here.

The markets whose data have been consolidated through CTA are fierce competitors. Cost-based rate regulation has consistently been seen in other industries to lead to poor cost control at best and, more often, to outright waste and mismanagement. The incentives on competitors to wring easy profits from a cost-regulated segment will be magnetic, and represent a real danger that will demand extensive government involvement. In contrast to the dramatic decline in market data costs over the past quarter century, under cost-based regulation, it is quite possible we would experience over time frequent rate increases based on escalating expense levels.

PHB includes a quote that we think captures the overall essence:

> Regulation, at best, is a pallid substitute for competition. It cannot prescribe quality, force efficiency, or require innovation . . . . Regulation fails to encourage performance in the public interest by offering rewards and penalties. Competition offers both."[12]

PART 2: THE TRACK RECORD OF THE NYSE BOARD

The cost-benefit analysis necessary to justify acceptance of the market distortions, costs and other pernicious effects of the "pallid substitute" would need to show that the pro-competitive alternatives had failed to realize the public policy goals of the 1934 Act. In fact, the record of constituent self-determination is one of exponentially increasing data access accompanied by consistent and dramatic declines in market data fees. In this Part 2, we look at the track record.[13]

A. Availability of Network A Data in the Marketplace

In 1975, Congress declared that market data would lie at the heart of the national market system. For the last 25 years, the Network A markets, under the Commission's stewardship, have sought to produce high-quality market data and to disseminate that data widely and on terms that are not unreasonably discriminatory and that are fair and reasonable.

How have they fared?

As the year 2000 began,

- 100 million people had on-line access to free real-time Network A data on public web sites;
- 70 million cable television subscribers had free access on their television screens;
- 12 million nonprofessional investor accounts had on-line access from their brokers, most free of charge;
- Industry professionals had access on 420,000 display devices located in offices around the globe; and
- 350,000 nonprofessional subscribers had signed up for unlimited real-time services with vendors and broker-dealers.

Are fees deterring widespread access to Network A data (as the Concept Release asks)? This record speaks for itself. As the Commission noted on the eve of the present controversy in the context of approving fees for the redistribution of options market data:

> Competition among technology and information providers continues to thrive. Over the past few years, individual investors have enjoyed unprecedented access to market data through varied media, including CNN, CNBC, satellite services, on-line computer services, the World Wide Web, and the Internet.[14]

Today, an investor has access to real-time Network A data by means of his or her PC, hand-held computer, telephone audio voice response, cellular phone, pager device, automated teller machine and public ticker display. They can see it while dining in a restaurant, while passing through Grand Central Station, while standing in Times Square, while shopping at a mall, while flying in a plane, or while watching television. In short, Network A has fashioned policies and practices that have released the Internet and cable television to democratize market data. As a result, real-time Network A data is ubiquitous, inexpensive to vendors and available to consumers for free.

In addition, system investments have created such redundancy and dependability that both the Consolidated Tape System ("CTS") and the Consolidated Quotation System ("CQS") have compiled uptime percentages that have remained above 99.9 percent ever since the systems commenced operations in the 1970's. And the markets have invested billions of dollars in technical infrastructure that enables last sale prices and quotations to be delivered to CTS and CQS for distribution to broker-dealers and vendors without queues regardless of increases in volume due to market volatility, decimalization or other changes.

As for Congress's goal of dissemination on terms that are not unreasonably discriminatory, Network A's policies and uniform contract terms assure that no one gets better terms of access than anyone else. Network A imposes the same market data fees on broker-dealers regardless of their SRO membership, and subjects all vendors, broker-dealers and investors to the same fee schedule, regardless of geographical location.

Network A's fee structure does differentiate among different classes of data recipients and provides volume discounts and an enterprise cap. However, in each instance, the markets' diverse constituents and the Network A participants' constituency-laden boards of directors, indicated that they viewed the disparities in Network A fees as reasonable and appropriate, as has the Commission.

As for distribution on "fair and reasonable" terms, the numbers make the case for the fairness and reasonableness of Network A fees. Since 1985, the securities industry's cost per transaction for each Network A real-time trade or quote message has shrunk from $1.00 to 23 cents. Taking into account inflation, all classes of fees have been consistently and dramatically reduced over the last 25 years. The repeated explicit and implicit price reductions have had the desired effect - extraordinary growth in market data usage. Yet, even with that growth, *the revenues from those fees fund the same portion of the Exchange's operations (14-17 percent) as they did a quarter of a century ago.*

Above all, Network A fees are "fair and reasonable" because the process by which the fees are determined is fair and reasonable. Network A fees are the product of the consensus building, compromise and negotiation process described below. Constituent boards have approved them all. The Commission, after subjecting each fee or fee change to public comment, has approved it or declined to abrogate. This process ensures that it is the consensus view, rather than the "outlier", that prevails.

Constituent self-determination has succeeded in fulfilling Congress's market data objectives by coupling advancing technology with innovation and adaptation. Application of new technology to the auction process has successfully accommodated massive increases in capacity demands, while making high-quality data available on a very reliable basis to retail investors at zero cost.

The heart of the national market system never misses a beat.

B. Constituent Governance

Market data dissemination is governed today by the industry and the investing public, operating through the representative boards of the SROs. The checks and balances in the current system insure that any latent market power is not exercised. It would upset the balance of this system and introduce significant inefficiencies if the Commission were to impose an additional layer of governance, or were to insist that market data fees should be earmarked for particular purposes, such as market regulation, to the exclusion of others.

Decisions by markets regarding the pricing of market data (indeed, all pricing decisions for all services) involve input and controls from a wide variety of industry participants and investors through the constituent boards of the various markets. These boards include CEOs of member firms and institutions, and leaders drawn from the general public. In the case of the primary listing markets, they include listed company CEOs as well.

For example, the NYSE board is carefully balanced to include both member and non-industry representatives, and among the members, to include representatives from various business segments, floor and upstairs, institutional and retail, regional and national, discount and full service. This extraordinary body comprises some of the most knowledgeable and influential people in the securities industry and, indeed, in the world of business as a whole.

As is commonly the case, the NYSE Board acts by majority vote. However, as is also common in business today, there is a real emphasis on achieving consensus, so that any serious concern or objection from a constituent will prompt an effort to satisfy the concern through negotiation and compromise before taking the contemplated action. One dissatisfied customer may not be able to force a change, but when a critical mass of our constituents voice a point of view, the Exchange's view is changed. It is in this way that any latent monopoly pricing power or power to discriminate among users with respect to market data is in fact controlled, directly or indirectly, by representatives of the very customers who use and pay for that data.[15]

CTA today is a forum in which markets can discuss issues that exist among them; it is not where pricing decisions are made. Those decisions are made by the boards of the participant SROs, where the customers and the representatives of the public reach consensus on pricing and other terms.[16] With respect to Network A, the NYSE will typically take the lead on pricing proposals, vetting new proposals not only with the other participants, but also with various users, and with trade and industry groups. This dialogue often results in modifications which improve or reevaluate the original concept. Proposals are then taken before the NYSE Board and the boards of the other CTA participants for approval.

And, of course, pricing and other rule changes are subject to the approval process at the Commission after public comment. In addition, both SRO and Commission rules provide procedures for broker-dealer members (in the case of SROs) and any person who believes his or her access has been limited (in the case of the Commission) to seek redress of their grievances.

Superimposing yet another layer of governance would stifle self-determination, not enhance it. This is especially true if that layer is added at a level where, by definition, the governors are removed from an immediate and full understanding of market costs and expenses, and are instead myopically focused on minimizing market data fees. Moreover, it seems inevitable that broker-dealer and institutional investor representatives on such a special-function body would be drawn from the ranks of their administrative and technical employees. This kind of representative cannot be expected to have the "big picture" view found in the chief executives who serve on the boards of the markets and who bring that broader perspective to the board deliberations on various fees, including market data fees. It would make no sense to permit a less qualified group to effectively strip cost allocation decisions from the user chief executives found on the boards of the NYSE and the other markets.

C. Fair Allocation of Costs: Nobody Does It Better

Has our constituent-driven process for allocating costs done so fairly? From some media accounts over the past three years, one would think that the process foundered on the issue of cost allocation between on-line brokers and full-service brokers. But the facts tell a different story.[17]

The on-line brokers believe that it is the obligation of a for-profit company to "exploit every economic advantage".[18] Therein lies the truth about the recent history of this allocation process.

It is the story of the attempt by one category of broker-dealer to foist the costs of operating the markets onto other categories of broker-dealers or onto listed companies. The on-line brokers seek to escape the market data fees that apply to their business model, to confine market data fees to the recovery of a narrow band of marginal costs, or to vaporize market data fees altogether. Until recently, the main thrust of this campaign was against our allocation of costs between those broker-dealers that provide market data to customers during telephone calls with their RRs, and those that provide market data to customers on-line.

The on-line brokers' campaign began in 1997 with an attack on Network A's penny-per-quote filing. When, at the Commission's request, we re-channeled the penny-per-quote fee into a new pilot, the lobbyists for the on-line brokers carried the campaign to Capitol Hill, arguing that "The Data Belong to the People". Ostensibly seeking to protect consumers from charges of a few pennies per day, the lobbyists neglected to mention that no on-line customer pays for market data unless the broker chooses to pass through the markets' charges.[19]

When the campaign to nationalize market data bogged down on the Capitol steps, the on-line brokers opened a new front. "The subject Consolidated Tape Association/Consolidated Quotation (CTA/CQ) plans and the comparable fees imposed by NASD . . . are levied only on brokerage customers electronically accessing market information. Such fees are not levied on investors that receive quotation information verbally from their brokers over a telephone."[20] This time, they had to retreat outright, conceding that, when a firm's RR gives a customer a quote over the phone, it is conceptually the same as when the firm gives the same quote to the same customer on-line.[21]

With their discovery that market data is free to consumers and that broker-dealers are paying for both the telephone/RR channel and the on-line channel, the on-line brokers had to open a third front. Now, they assert that "triple billing" and "multiple channel penalties" are discouraging "innovation, efficiency and convenience of investor access."[22]

Are they?

We have charged separately for separate "channels" since the interrogation device augmented the ticker in 1960. It is just one of the many tools that NYSE's constituent board uses to fairly allocate its costs among constituents. Clearly, to the extent that two competing constituents pursue different business models that rely on different dissemination channels, we could not impose fees on one channel while leaving the other one free of fees, and still fairly allocate costs and avoid unreasonable discrimination. If one customer receives a certain amount of data through *three* channels, and a second receives the *same* amount though *one* channel, how is it "triple billing" if we charge the provider of data to the first customer the same amount as we charge the provider to the second customer?

Moreover, over time, vendors and broker-dealers shift channels - even if we have been successful in setting our fees neutrally between the two. For example, over the past 30 years, the interrogation device channel has largely supplanted the ticker channel in the professional category.[23] That channel shift was attributable to the inherent limitations in ticker technology: ticker throughput is governed by the speed at which a human eye can perceive moving characters.

Clearly, if we are to recover a fair share of our costs through market data revenue, we must be able to charge for the supplanting channel. Fortunately for fair allocation, during the 1970's, no one was able to convince the Commission that charging for the interrogation device channel was in some way inimical to the public interest.

Today, a channel shift is going on within the non-professional category from the telephone/RR channel to the on-line channel. There appear to be two principal reasons. The first is similar to the one that led to the marginalization of the ticker channel: today's individual investor wants the same analytical abilities as the professional; plummeting technology and communication costs have brought those analytical tools within the reach of his or her wallet; and a stream of electronically-delivered dynamically-updated data is essential to that capability.

The second reason has no counterpart in the earlier channel shift: the brokerage firms are pushing their customers into the on-line channel because self-help by customers reduces RR payroll and other overhead.[24]

If achieving fair cost allocation and avoiding unreasonable discrimination requires extending fee liability to new channels, then the question becomes one of "how." If we were comparing "apples to apples" (as was implicit in the example above), then "1X times 3 channels = 3X times 1 channel", and one can apply the same price tag to each unit of data.

Unfortunately, in allocating costs between the two nonprofessional channels, we must compare "apples to oranges". In the "telephone/RR" model, a firm tasks an RR to work from a fee-liable interrogation device to telephonically provide a customer with a small, discrete number of quotes. In the on-line model, the firm arms the self-help customer with an array of information and analytic tools that allows the customer to access and manipulate large numbers of quotes. Thus, the quality, nature and use of the data are different.[25]

We approached this allocation task in several steps as experience educated us. In 1984, we established an "all-you-can-eat" device fee for non-professional subscribers at a fraction of the professional device fee. By the early 1990's, changing technology and business models were militating for alternative fee approaches.

We responded, first, by holding the professional device fees nominally constant and piloting three on-line fee alternatives: flat-rate, connect-time and per-quote. Second, when the per-quote alternative proved the best, we adopted it.[26] Third, as the use of the channel increased and, therefore, our revenue from the channel increased, we twice rebalanced against the telephone/RR channel by reducing the fees attributable to on-line receipt.[27] Fourth, we introduced quote-volume discounts and per-customer caps, providing to the on-line channel the same benefits of discounts as are available to the telephone/RR channel.[28] Fifth, we added an enterprise cap applicable to all channels, which ameliorates the issue for any firm that reaches it.[29]

We think the Exchange's constituent-driven process has done a good job of meeting the fair allocation challenge presented by the emergence of the on-line channel.[30] In particular, we avoided favoring one broker-dealer business model over another. We also expect that the growing homogenization of the brokerage industry in its use of on-line data dissemination will tend to moot the issue. Moreover, while we would gladly consider other approaches, we suspect that the array of channel fees, discounts and caps now in place position us with the tools necessary to easily re-balance the cost allocation between the telephone/RR channel and the on-line channel for a third time, should that again become necessary.

But, above all, we believe that no government rule-making bureaucracy or supra-SRO governing body, even if it could have achieved neutrality and escaped co-option, could have done a better job.

PART 3: CONSOLIDATION TECHNOLOGY, FREE MARKETS AND CONSTITUENT BOARDS

After 25 years of data dissemination through SRO joint ventures, the Commission is right to ask whether changes in technology and in the competitive landscape ought to change who should allocate market costs among users, and how. The Concept Release proposes introducing a form of price controls by adding one or more levels of government or superimposing a supra-SRO bureaucracy.

We think just the opposite tack - dissolving the joint ventures - offers the best solution. Here, as in other areas of the economy, the best answer lies in unleashing market forces and relying on constituent self-determination. If we unbundle the data and dissolve CTA and the other joint ventures, we will free the markets to compete in the data arena - as they do in all others - by pricing and selling their product individually.[31] The very act of dissolving the joint ventures will give full reign to the markets' constituent boards to control market costs and to fairly allocate those costs among constituents within the Commission's framework of mandatory dissemination and mandatory consolidated display of the data.[32]

While there was a technological reason for forming an SRO joint venture to create a consolidated tape in the mid-1970s, technology has long since removed the systemic and economic barriers to consolidation either by each vendor or broker-dealer independently or by non-exclusive service bureaus performing the function at market rates. In the related context of his proposal for consolidated dissemination of limit orders, Chairman Levitt recognized this feasibility in his call for vendors and others to create consolidated displays of limit orders.[33] We see no reason why a market solution for consolidation that appears both workable and consistent with the goals of the 1934 Act for limit orders would not be equally workable and consistent for bid-asked quotations and last sale prices. [34]

A market solution coupled with constituent self-determination under Commission oversight addresses the Commission's concerns about undesirable effects of the current joint dissemination arrangement. For example, the Commission is concerned about whether the revenue received by the regional exchanges and the third market exceeds the value of their data.[35] We assume that market forces will readily address any value distortions inherent in the joint venture arrangement if the markets are freed to compete among themselves in separately pricing their market data. We have also seen in a variety of contexts the Commission's desire to increase quote competition. Intermarket competition in the market data arena will create incentives for more competitive quotations in order to create the value proposition necessary to make market data users willing to pay for the data.[36]

The Commission also expresses concern in the Concept Release about the lack of correspondence between the joint venture's revenue allocation and the costs of operating the regional exchanges and the third market. As noted above, this lack of correspondence arises because the plan fees are based upon the more extensive costs of the infrastructure of the Exchange and the other primary markets, but shared with the regional exchanges and the NASD according to a formula that is not correlated with the costs of the regional and third markets or the value of the derivative prices those markets produce. Subjecting each market separately to the test of competition would flush out any systemic inefficiencies built into market data pricing by the joint venture arrangement.

Shutting down the joint ventures would also moot a variety of other controversies that have been plaguing the markets and the Commission - none of which is unresolvable, but all of which place additional demands on scarce Commission resources. For example, because the CTA Plan - drafted at a time when all exchanges had physical trading floors - provides a fee exemption for terminals on trading floors, the Commission is faced with an appeal by a floor-less exchange. Another participant filed a petition with the Commission last year regarding a dispute over whether a particular security was eligible for revenue sharing under the Plan. The options exchanges have been arguing with a new, floor-less entrant as to whether it should be able to directly provide its own last sale prices and quotations to its members. In addition, the options antitrust investigations and lawsuits have impaired the functioning of meetings of the joint ventures because businesspeople are afraid to talk to one another unless they have an antitrust lawyer on one side and a Commission staff member on the other.

The collateral effects extend to fundamental issues about the self-regulatory structure. The motivations of some of the ECNs to register as national securities exchanges include sharing in the joint venture revenue, forcing the Commission staff to devote considerable resources to help the ECNs meet the daunting statutory standards for registration. In turn, the prospect that the Commission would then have to regulate the ECNs directly contributes to the call for the creation of a monolithic SRO cleaved from the primary markets. And the question of the amounts that the new joint-venture entrants should reimburse the existing co-venturers has caused the Antitrust Division of the US Department of Justice to weigh in.[37]

These changes should also benefit the overall competitiveness of the US capital market. This Commission has led the way in recognizing how changes in technology and in the economy have enabled market solutions to replace the non-market solutions of the last generation. Examples include increasing non-industry participation on the boards of the NASD and Philadelphia Stock Exchange; opening the NASDAQ markets to competition from order-match systems by imposing the order handling rules; breaking open the single-exchange order-routing channels left behind by the options allocation plan; enhancing listing competition by removing shareholder approval requirements for delisting; proposing alternatives to exchange rules that address fragmentation and internalization by confining proprietary trading to exchanges; and decimalization. Ending the SRO joint ventures would extend this Commission's pro-market legacy.

The Concept Release suggests that the Commission may be coming to the view that the competitive costs of the joint ventures now outweigh their benefits. Predecessor Commissions found that the joining of the competing markets into these ventures was necessary or appropriate under the 1934 Act and that other 1934 Act purposes outweighed the competitive burdens. On the other hand, the sea change in technology over the last 25 years has clearly enabled solutions that were previously unavailable, and we can understand that this Commission may take a different view today. While we were and are willing to deal with the existing inefficiencies of the joint ventures if that is required, we would welcome the unfettering of competitive forces.

In sum, we believe that all of these factors mean that it is time to dissolve the joint ventures. While there are many transitional issues that must be addressed, we believe they are all manageable. Working with the Commission staff, with the other participants in the market data plans, and with the brokerage firms, vendors and other data recipients, we believe an orderly transition to competitive dissemination of market data could be effected by the end of this year.

* * *

We hope that this letter and its appendices at last bring facts and clarity to the debate and assist the Commission in making choices that will have a significant impact on the vitality, viability and operational stability of the U.S. securities markets in the years to come. We have shown that cost-based pricing by a Government bureaucracy is "a pallid substitute for competition", untenable as a way of assuring adequate and fair funding of the markets, costly and without statutory foundation. We have also shown that the retention of the joint ventures, not to mention the superimposing of a supra-SRO body, exacerbates the issues discussed and implied by the Concept Release. We have pointed out how prolonging the joint ventures only serves to impede the market forces and the constituent self-determination that provide the key to resolution of these issues.

We believe that dissolution of the joint ventures is the appropriate solution. Accordingly, we have been authorized by our Board to seek the Commission's approval to withdraw from the CTA and CQ Plans.

Sincerely yours,

James E. Buck

Footnotes

[1] The budgetary and cost-allocation process conducted by the Exchange's constituent board yields an allocation of costs to the Exchange's market data revenue source that provides the basis for the fees under the Consolidated Tape Association ("CTA") and Consolidated Quotation ("CQ") Plans. However, the Plans' revenue sharing formula, which is based on each market's proportion of trades in NYSE-listed stocks, entitles the Exchange to receive about 75 percent of the total revenue.) As a consequence, the sharing of the remaining 25 percent by the other markets does not correlate to their costs or the value of their data.

[2] Also by way of assistance to the Commission and its staff, **Appendix A** lists the questions posed by the Concept Release and identifies where in this letter or in its appendices the questions are addressed.

[3] Winston Churchill, November, 1947.

[4] Pub. L. No. 94-29, 89 Stat. 97 (June 4, 1975).

[5] The markets' right to charge for market data emanates, inter alia, from their proprietary rights in the data. As the Concept Release points out at pp. 26-29, the Supreme Court has affirmed those proprietary rights on multiple occasions. Commentators who argue that Section 11A's regulation equates to nationalization or other extinguishing of the markets' proprietary rights

fail to understand the distinction that 70 years of Supreme Court decisions draw between (1) an overlay of Federal regulation of interstate commerce that preserves property rights and (2) a regulatory "taking" that, absent just compensation, would be unconstitutional.

6 The case in point (NASD/Instinet) is discussed in Appendix B at p. 21 and Appendix C-2 at pp. 39-40.

7 One of the PHB reports, "Issues Surrounding Cost-Based Regulation of Market Data Prices," provides a view of cost-based pricing from a historical regulatory perspective and is attached as **Appendix C-1**. The other, "The Economic Perspective on Regulation of Market Data," provides an economic assessment of cost-based pricing and is attached as **Appendix C-2**.

8 Given the importance we attach to a clear understanding of the purposes and effects of rate regulation in this area, we have authorized PHB, and their experts have agreed, to make themselves available to discuss these issues with the Commission and the Commission staff if that would be helpful.

9 In the last section of Appendix C-1, our rate-regulation experts take a detailed look at the history of rate regulation for the airline, natural gas, electric, telecommunications, cable television, oil pipeline, postal service, and railroad industries (i.e., the US industries that Congress and the states subjected to rate-regulation over the past century). In every single industry, the history reveals a clear march away from rate regulation.

10 The PHB experts also independently agree with our own observations and those of Debevoise & Plimpton (see Appendix B) that the 1934 Act does not contain the sort of specificity about rate regulation found in other statutory schemes that would support utility rate-making by the Commission. (See Appendix C-2, pp. 4-5 and 11-12.) In addition, they observe that the current form of regulation has been successful in making market data widely available, and that no case has been made that a change in regulation is needed.

11 Among other steps involved in introducing a price-setting regulatory regime, the Commission would have to determine that rate regulation of market data would make data more widely available to individual investors or otherwise improve their welfare; establish the basic principals of the form of cost-based regulation that it determines to best suit the securities industry, including appropriate rates of return and appropriate methods for evaluating asset bases (e.g., historical vs. replacement values); become intimately familiar with the day-to-day operations and costs of each SRO and assess all elements of production for each SRO, including trading floor and other infrastructure systems, redundant and back-up systems, excess capacity and security; determine rules for allocating fees between different business models (e.g., for equating fees for on-line services to fees for telephone-based services); define "direct costs" and permissible operating costs; determine the categories of costs in addition to "direct costs" that SROs may recover; determine rules for allocating overhead costs; codify categories and sub-categories of costs; establish a uniform system of accounts; perform an in-depth study of each market's structure; establish accounting rules relating to such things as cash or accrual accounting, capitalization, permissible depreciation and obsolescence methodologies, includable plant and equipment expenses, taxes, debt, losses, payroll allocations, extraordinary items, and contingent assets and liabilities; establish reasonable guidelines for allocating a market's many joint and common costs, including an assessment as to whether different allocation rules are appropriate for the different networks; establish rules for each network's

initial setting of market data fees under the new regulatory regime and procedures for changing those rates; assess the effects of rates and rate changes on demands for (a) market data services, (b) the costs of supply and (c) other SRO services; establish reporting and record keeping rules and regulations; establish rules for fee adjustments necessitated by the entry of new SROs; establish rules for the distribution of market data revenues among SROs; establish rules for the allocation of a market's costs among multiple networks; review SRO cost studies; hold formal hearings (with briefs, reply briefs, testimony, witnesses, opinions, appeals, etc.) to review new fees and fee changes, and new regulatory rules or changes to those rules; hold a hearing for each SRO to determine its asset-base valuation and allowable rate of return; defend court challenges to its hearing determinations and to many of its other determinations; estimate the annual burden of any new reporting, record keeping or other regulation for the Office of Management and Budget; estimate the paperwork burden attendant to the new regulation as required by the Paperwork Reduction Act; hire attorneys, accountants, economists, consultants, lobbyists, programmers, data-entry personnel, personnel to respond to SRO inquiries, form reviewers, and enforcement/compliance personnel as necessary to perform all of the above functions; and determine whether each of the above-described steps require counterparts to distinguish between not-for-profit and for-profit SROs (e.g., two systems of accounts, two rate-of-return procedures and two sets of allowable depreciation methodologies).

In describing difficulties associated with those many functions, PHB uses such phrases as "has involved years of formulation," "can take several months, if not several years," "will prove controversial," "Herculean task," "rarely completed to the satisfaction of all parties," "not a trivial undertaking," "would be highly contested," "a regulatory agency would have a difficult time in achieving its goal," "hearings are often lengthy and contentious, with large volumes of evidence and supporting documentation," "cost studies contain volumes of information," and "significant problems attendant to measuring the cost of capital."

Once the new rate-making system becomes operational, the Commission would then have to perform the many functions necessary to maintain it and to monitor and enforce SRO compliance. And, of course, the regulated markets would have to take all of the steps necessary to institutionalize the Commission's new regulatory regime and to incur the many on-going obligations necessary to comply with that regime. According to PHB, history teaches that the markets will incur far greater costs and burdens than the Commission, noting one economist's estimate that regulation requires regulated firms and other governmental agencies to spend $40 for every $1 that the regulating agency spends.

[12] Claire Wilcox, *Public Policies Toward Business*, (Irwin, 1966) at 476. Quoted in Appendix C-2, p. 19.

[13] A more detailed review of the history of Network A pricing and evolution, as well as a record of what Network A has accomplished, can be found in **Appendix D**, "Network A in Perspective: 1975-2000".

[14] Exchange Act Release No. 36542 (Nov. 30, 1995); 60 Fed. Reg. 62908, at p. 62910.

[15] The Concept Release points to the potential demutualization of the markets as one of the concerns that in part supports its rate-making proposal. (Pp. 7-8.) Leaving aside the questions of how soon demutualization of the primary markets will actually occur and the wisdom of

trying to anticipate the collateral consequences, we note that even the partial demutualization of the NASD represented by the NASD's proposed partial spin-off of the NASDAQ Stock Market anticipates the continuation of a constituent board structure at the NASDAQ level (as well as the NASD level) - as is the case at the NASD's Amex subsidiary today. This underscores that a board representation of all constituents is not the outgrowth of a broker-dealer cooperative: indeed, until 1972 in the case of the NYSE and 1996 in the case of the NASD, there was only nominal representation on their respective boards of non-industry constituents. Rather, non-industry constituent representation is the outgrowth of the markets' recognition of the necessity of enfranchising the broader constituency they serve (see, e.g., the NYSE's Martin Report of 1971 and the NASD's Rudman Report of 1995). In other words, a constituent board is completely compatible with a demutualized ownership structure and completely sustainable as a function of the requirements for exchange registration. The recent registration of the for-profit International Securities Exchange further underscores the point.

16 Neither the CTA Plan nor the CQ Plan provide for separately-incorporated organizations, redundant governing bodies or independent staffs. Meetings are at the level of operations personnel with no discretion to make fee or other substantive policy decisions. None of this is an accident.

17 Because it has been the target of attack, this cover letter addresses in detail the issues of fairly allocating costs between broker-dealers using the telephone/RR channel and those using the on-line channel, and of avoiding unreasonable discrimination between them. The Concept Release also seeks comment on other cost-allocation decisions represented by, e.g., enterprise caps and volume discounts for devices (pp. 74-75). We discuss those in Section I of Appendix E.

18 March 14, 2000, letter from David S. Pottruck, President and Co-Chief Executive Officer, Charles Schwab & Co. Inc. ("Schwab"), to Jonathan G. Katz, Secretary, SEC (the "Pottruck Letter"), p. 9.

19 See, e.g., "The Consumer and Investor Access to Information Act of 1999", Wednesday, June 30, 1999, House of Representatives, Committee on Commerce, Subcommittee on Finance and Hazardous Materials ("House Data Hearings"), p. 57. Schwab finally concedes this pass-through point in its comment letter responding to the Concept Release. Pottruck Letter, pp. 2, 5.

20 [Sic.] July 20 and 21, 1998, letters from Michael J. Anderson, as President, National Association of Discount Brokers, and as President, Ameritrade, Inc., to Jonathan Katz, Secretary, SEC, pp. 1.

21 Pottruck Letter, p. 5. However, E*Trade is still asserting that consumers pay the fees for the on-line channel and that no fees apply to the telephone/RR channel: "The only retail investors assessed fees for their consumption of market information are those that obtain it on-line." February 16, 2000, letter from Henry W. Carter, Chief Compliance Officer and Vice President, E*Trade Securities, Inc., to Jonathan G. Katz, Secretary, SEC (the "Carter Letter"), p. 3.

22 Pottruck Letter, pp. 5, 13.

23 See Sections pp. 10-13 of Appendix D.

24 See **Appendix E**, "Comments on: Fee Discounts, Plan and SRO Disclosure, Administration, and Pilot Programs", note 16, p. 7. Not surprisingly, the contribution of fees attributable to broker-dealers' and vendors' provision of Network A market data to non-professionals (both

telephone/RR and on-line) has grown along with the increasing participation of individual investors in the market. However, fueled by the growth of the Internet, the shift *within* the non-professional category (i.e., between the two non-professional channels) has outpaced the overall growth in the category.

[25] The two channels also lend themselves to different metrics. The telephone/RR model lends itself to a fixed access fee - an "all-you-can-eat" device fee. However, from the firm's perspective, it is also a "pay-as-you-go" proposition since, when customer demand takes up all its existing RRs' time, it adds more devices (and RRs). Brokerage firms providing on-line services have opted for a "pay as you go" per-quote fee (now subject to an "all you can eat" monthly cap of $1.00). The economists call this a two-part tariff problem (see Appendix C- 2, p. 10.) The key idea is that there are no simple "right" and "wrong" answers, as some commentators would suggest.

[26] It was Network A's attempt to formally introduce into its rate schedule the approach of the winning pilot that precipitated the on-line brokers' campaign. *See* Appendix D, p. 15.

[27] In testimony before the House Commerce Committee last summer, representatives of Ameritrade, DLJDirect and Schwab all testified that any savings from rate reductions would be "very definitely," "absolutely" or "definitely" passed on to their retail customers. House Data Hearings, supra n. 19, p. 57. Network A subsequently slashed its on-line rates by 80 percent in the case of nonprofessional subscriber device fees and by up to 75 percent in the case of per-quote fees. Yet we see no evidence that any of these firms passed through the savings.

E*Trade and Schwab also continue to portray the earlier (1997) change as a price increase. (Carter Letter, p. 4, n. 6; testimony of Mr. Charles Schwab, Senate Banking Committee Hearing on the "Financial Marketplace of the Future," Tuesday, February 29, 2000.) In fact, it was a substantial reduction. Network A revenues immediately declined 50 percent despite continuing explosive growth in the category. (See Appendix D, p. 17.)

[28] See Appendix D, pp. 16 and 29. Comment letters from the on-line brokers that point to the 951 percent increase in the revenue from on-line fees from 1994 to 1998 neglect to mention the channel shift, the fact that the revenue increase lags the much more explosive growth in the on-line channel and the fact that the on-line revenues started from a near-zero base. Carter Letter, p. 2, Pottruck Letter, p. 2. See Appendix D, pp. 15-17.

[29] Schwab's David Pottruck was quoted as saying that the proposal was "a huge step in the right direction." Greg Ip, "Big Board Proposal to Cut Fees Charged for Stock Quotes Cheers Online Brokers," Wall Street Journal, April 2,1999, p. C17. Schwab echoed the sentiment this past fall when the Commission approved the proposal. "NYSE Fee Plan for Quotes Receives SEC's Approval," Wall Street Journal, October 8,1999.

[30] See also Section 1 of Appendix E.

[31] As the Commission recently pointed out in noticing our filing to rescind our off-board trading rule, "Ultimately, only fair and vigorous competition can be relied upon to set efficient prices." Exchange Act Release No. 34-42450, February 23, 2000, p. 33. Schwab embraces the same kind of approach: "If the forces of competition and supply and demand are allowed to work here and there is good input from all parties, we think there is no rate making necessary." House Data Hearings, supra n. 19, p. 60.

[32] The Commission and the Exchange agree that the issues discussed by the Concept Release arise from the joint dissemination that followed from the adoption of the 1975 Amendments. A senior SEC staff member said recently that "We're here because Congress set up the idea of a consolidated quote system, . . . essentially a monopoly." (BNA, Broker-Dealer Compliance, Vol. 2, No. 5, March 8, 2000.) It is important to remember, however, that Congress did not *mandate* joint dissemination. See Appendix B, pp. 7-8.

[33] "Visible Prices, Accessible Markets, Order Interaction," Remarks of Chairman Arthur Levitt at Northwestern University School of Law, Kellogg Graduate School of Management, March 16, 2000, p. 5-6.

[34] Whether there are four contracting authorities, as today, or several more in the future as a result of dissolution of the joint venture, we pledge to continue our work on easing the administrative burdens on the data recipients by seeking to standardize contract forms, policies and reporting requirements, to devise price structures that do not depend on counting devices, subscribers or quotes, and to bring more technology to bear to the process. (See Appendix E, p. 10.) In addition, to the extent that either the direct data recipients or the current plan participants were to find it cost-effective to use the Securities Industry Automation Corporation as a non-exclusive processor at market rates, we would have no objection.

[35] See Concept Release, pp. 78-79.

[36] The continuing requirement that prices be disseminated in a consolidated display will force data recipients to deal with each market. Apart from the fact that the data recipients are represented on the market boards, two other factors will discipline negotiations to prevent a market from using the consolidation requirement as leverage to charge unreasonable prices for its data. First, the data recipients have other business relationships with the markets (notably, order entry) that will affect the negotiations. Second, the Commission will continue to play the role that it has played for the last 25 years of providing the backdrop for those negotiations by virtue of its authority to approve SRO fees to assure that they achieve equitable allocation of reasonable fees and otherwise meet the standards of the 1934 Act. In this role, the Commission is armed with a panoply of tools by which to effect its oversight, including inspections, the ability to approve SRO rules, the ability to initiate amendments to SRO rules, and, as noted above, the "safety valve" afforded by its authority to conduct limitation-on-access proceedings.

[37] There may also be a cross-plan sheltering effect operating: Network A's unit cost to the securities industry in 1999 was 23 cents per trade/quote message disseminated. (See Appendix D, p. 8.) Network B's unit cost was more than seven times higher at $1.69.